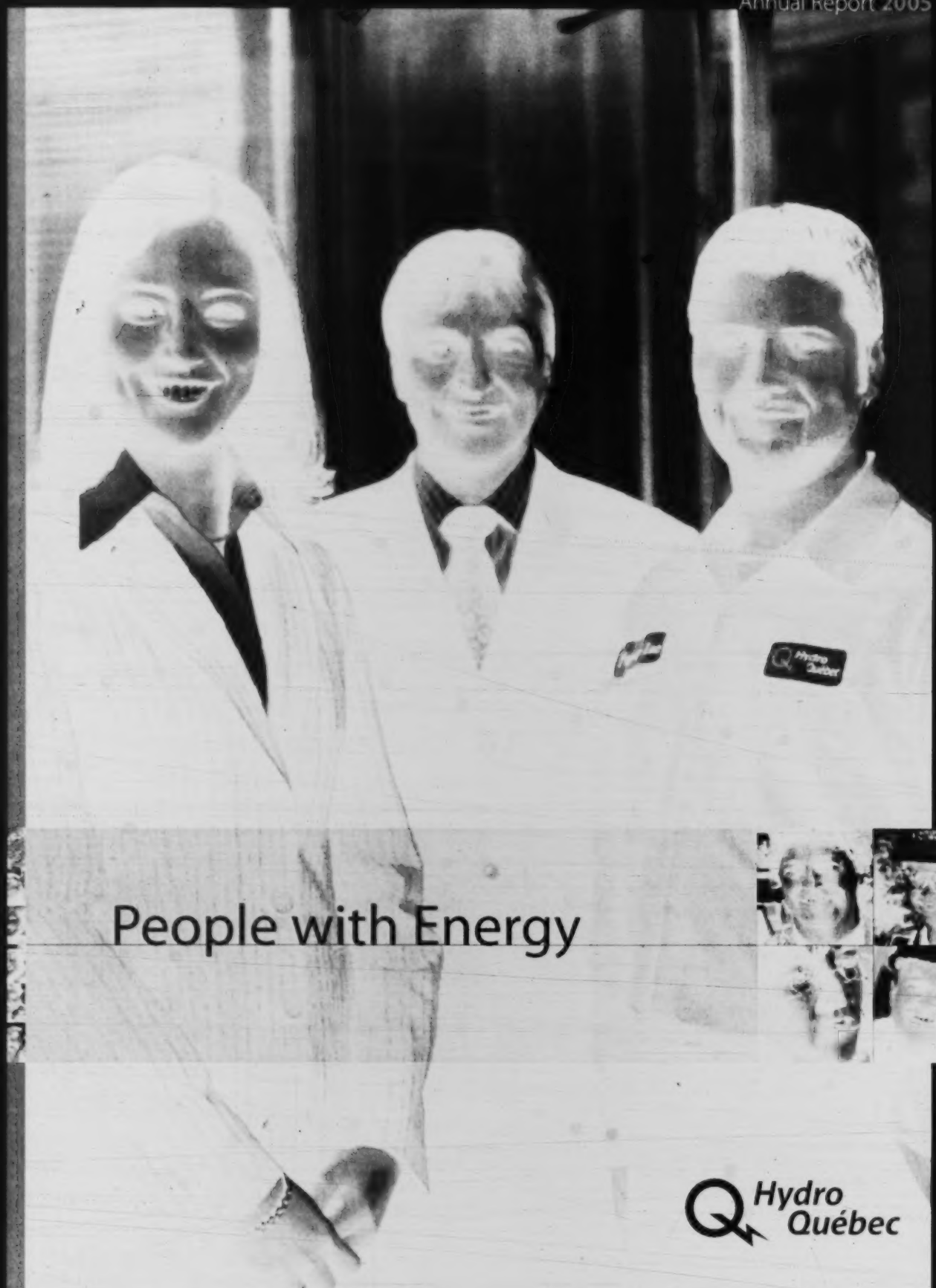
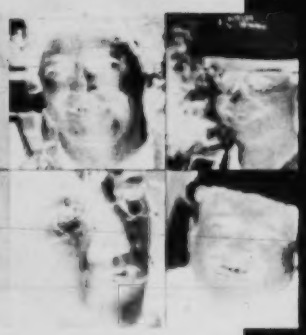
Annual Report 2005



People with Energy



Hydro Québec

Hydro-Québec generates, transmits and distributes electricity, mainly using renewable energy sources, in particular hydroelectricity. It also conducts research in energy-related fields and takes an active interest in energy efficiency. In addition, it works to create value from the technologies that emerge from its research.

Its sole shareholder is the Québec government. By law, the Generator supplies the Distributor with an annual heritage pool of electricity. Above that volume, the Distributor obtains its supplies on the open market. Transmission and distribution activities are regulated. The company comprises four divisions:

Hydro-Québec Production generates and wholesales power on domestic and external markets.

Hydro-Québec TransÉnergie operates the most extensive transmission system in North America for the benefit of customers inside and outside Québec.

Hydro-Québec Distribution provides Quebecers with a reliable supply of electricity. To meet needs beyond the annual heritage pool supplied by Hydro-Québec Production, it obtains supplies on open markets. It also works to encourage its customers to make efficient use of electricity.

Hydro-Québec Équipement and **Société d'énergie de la Baie James**, a subsidiary of Hydro-Québec, are the prime contractors in construction projects for Hydro-Québec Production and Hydro-Québec TransÉnergie.

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On the cover

Maria Moudfir
Counsel, Legal Affairs

Robin Dubé
Project Manager, Telecommunications

Pierre-Luc Francœur
Mechanic, Transportation Services

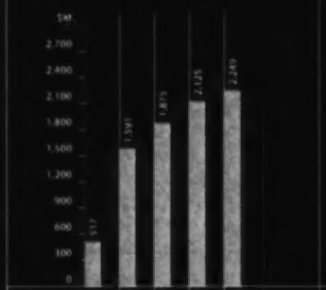
Unlimited reserves of energy

Hydro-Québec generates electricity from the natural elements: water, the original driving force behind our major achievements, and wind, our new and potentially powerful ally. But our success is built first and foremost on one vital resource: people with energy. Combining maturity with freshness of vision, experience with a desire to innovate, coolheadedness with conviction, and insight with enthusiasm, our employees are a boundless source of power.

Hydro-Québec at a Glance

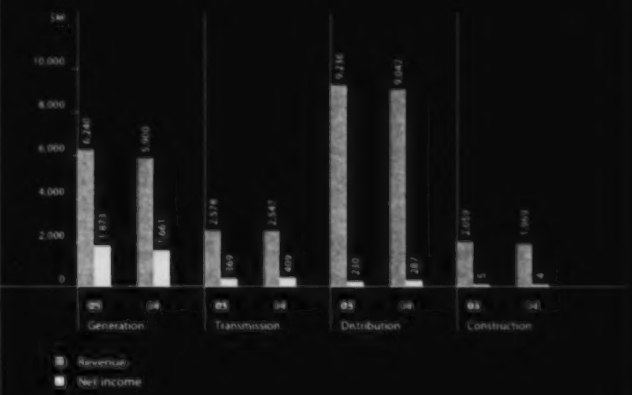
	2005	2004	Change (%)
Operations and Dividends ($M)			
Revenue	**10,890**	10,399	5
Operating income	**4,469**	4,239	5
Income from continuing operations	**2,249**	2,125	6
Discontinued operations	**3**	310	(99)
Net income	**2,252**	2,435	(8)
Dividends declared	**1,126**	1,350	(17)
Balance Sheets ($M)			
Total assets	**60,432**	58,118	4
Assets held for sale	**2,311**	–	–
Long-term debt, including current portion	**34,427**	34,517	(0.3)
Liabilities related to assets held for sale	**1,385**	–	–
Shareholder's equity	**17,376**	16,220	7
Cash Flows ($M)			
Operating activities	**4,423**	3,923	13
Investing activities	**(3,694)**	(1,970)	88
Financing activities	**(867)**	(1,959)	(56)
Cash flows from discontinued operations	**135**	(86)	257
Cash and cash equivalents at end of year	**92**	97	(5)
Ratios (%)			
Return on equity	**13.4**	15.5	(2.1)
Average cost of debt	**7.6**	6.8	0.8
Return on revenue from continuing operations	**20.7**	20.4	0.3
Capitalization	**34.2**	32.8	1.4
Self-financing	**56.9**	75.3	(18.4)

Income from Continuing Operations[a]



Income from continuing operations reached $2.25 billion, which is $124 million more than in 2004. This increase is attributable to higher operating income, offset in part by higher financial expenses.

Revenue[b] **and Net Income by Segment**[a]



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	2005	2004	2003	2002	2001
Customers and Sales					
Total customer accounts in Québec	**3,752,510**	3,701,275	3,644,463	3,596,542	3,557,291
Electricity sales in Québec (TWh)	**169.2**	165.9	167.1	158.6	152.2
Electricity sales outside Québec (TWh)	**15.3**	14.4	15.8	54.2	42.4
Number of Employees[a]					
Permanent as at December 31	**19,009**	18,835	18,317	18,025	17,679
Temporary (year's average)	**3,577**	3,567	3,596	3,632	3,545
Facilities					
Number of hydroelectric generating stations	**54**	53	52	51	51
Total installed capacity (MW)[b]	**34,571**	33,892	33,616	32,661	32,654
Peak power demand in Québec (MW)[c]	**33,636**	34,956	36,268	34,989	30,080
Lines (overhead and underground)					
Transmission (km)	**32,544**	32,487	32,434	32,314	32,273
Distribution (km)[d]	**108,344**	107,423	106,568	105,871	105,352
Number of transmission substations	**505**	506	506	505	504
Power Generation and Purchases					
Renewables (GWh)	**183,399**	175,704	180,556	183,304	174,419
All generating sources (GWh)	**192,862**	188,269	191,841	191,491	184,543
Proportion of renewables (%)	**95**	93	94	96	95

a) Excludes employees of subsidiaries and joint ventures.

b) In addition to the installed capacity of its own generating stations, Hydro-Québec has access to most of the output from Churchill Falls, which has a rated capacity of 5,428 MW, and to all of the output from the 196 turbines at five wind farms with a total installed capacity of 210 MW.

c) Total power demand at the annual domestic peak for the winter beginning in December, including interruptible power.

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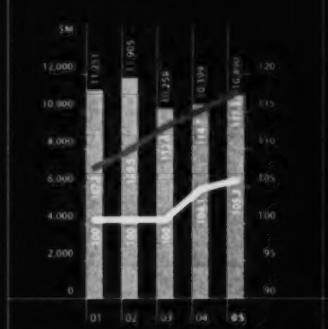
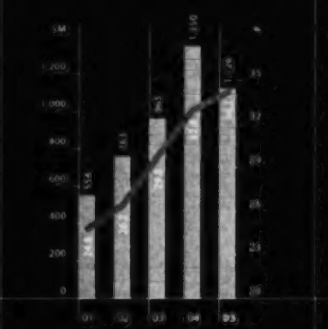
Revenue,[a] Average Rate Increase Index and Consumer Price Index



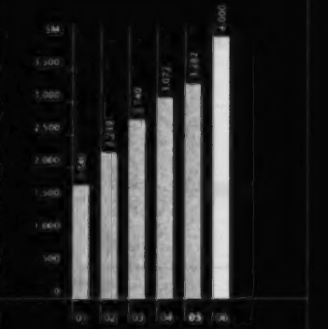
Revenue totaled $10.9 billion, up 4.7% over last year. This increase is the result of our good performance on external markets and higher revenue from electricity sales in Québec.

Dividends Declared and Capitalization[a]



Dividends of $1,126 million, or 50% of net income, were declared. This will be the ninth consecutive payment to our shareholder, the Québec government, and will bring the total paid since 1998 close to $6.4 billion.

Investments in Property, Plant and Equipment and Intangible Assets[b]



Cash from operations stood at $4.4 billion. Combined with revenue from the sale of the assets of subsidiary HydroSolution ($92 million) and funds repatriated to the parent company from a foreign subsidiary ($309 million), these funds made it possible to pay the dividends of $1,350 million declared in 2004 and to finance a substantial portion of our $3.3-billion capital program.

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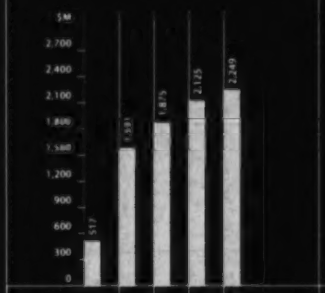

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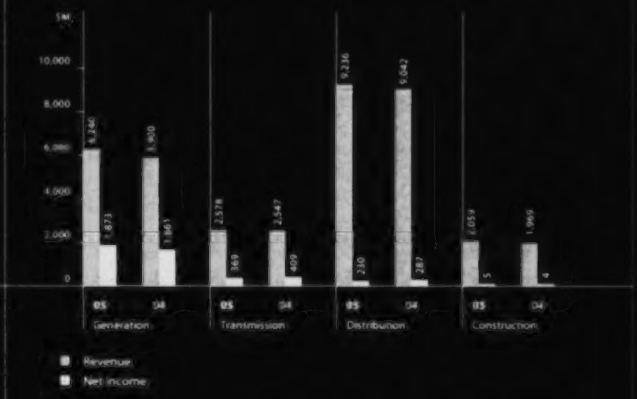

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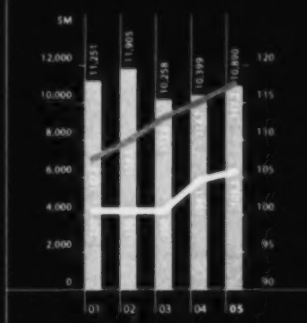

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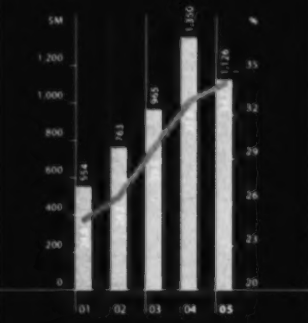

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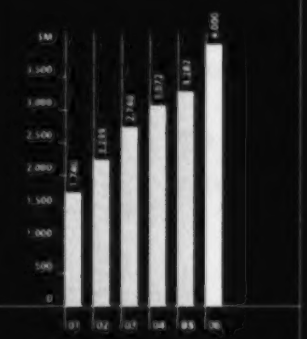

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Integrity and transparency

Hydro-Québec's financial results for 2005 exceeded our expectations, testifying once again to the resourcefulness and teamwork of the company's employees and executives. The Board of Directors is delighted with this excellent performance.

During the year, the Board of Directors focused on the company's main business objectives for the coming years, at the same time as it worked with Corporate Management to achieve its short-term objectives. The analysis and preparation of the Business Plan and the Strategic Plan were monitored periodically. A number of financial and technological issues held the Board's attention, including integrated enterprise risk management and the capital investment program.

The Board of Directors was proud to recommend that the government appoint Thierry Vandal as President and Chief Executive Officer, in April. Mr. Vandal brings to this position his longstanding experience with Hydro-Québec and his in-depth knowledge of the energy industry.

In terms of governance and ethics, Hydro-Québec applies strict rules of conduct based on best practices. In 2005, the Board initiated a review of its own operations with the intention of making its discussions with Corporate Management more flexible and dynamic. To safeguard the shareholder's interests, it can count on high-calibre members who come from various spheres of activity and offer a wide range of viewpoints. All are motivated by the same concern for integrity and transparency.

I would like to express my appreciation for the dedication shown by all Board members. Special thanks are owed to outgoing Board members Michel Boivin and Sophie Martin, as well as André Bourbeau, who was Chairman until April. Welcome to Marie-Anne Tawil and Normand Bergeron, who joined our ranks during the year.

Finally, our heartfelt thanks go to André Caillé, who left Hydro-Québec in 2005. He has bequeathed to us an efficient, financially solid organization that is ready to make the most of the exciting times we are witnessing in the energy sector.

Michael L. Turcotte
Chairman of the Board

Hydro-Québec has adopted some of the highest possible governance standards. Its practices are a guarantee of integrity.

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A productive year

In 2005, we continued working on the development of hydroelectric potential and the security of energy supply in Québec. In addition to maintaining our profitability, we made strides in the area of energy conservation.

Income from continuing operations totaled $2.25 billion, up from $2.13 billion in 2004. This $124-million increase is largely attributable to a rise in domestic sales and net short-term exports. However, it was mitigated by the higher pension expense, depreciation and amortization, cost of supply on external markets and financial expenses. It is worth noting that other than the pension expense, operating expenses were lower than in 2004. The company's solid financial health allows it to pay dividends to the Québec government, its sole shareholder, and to continue investing in development projects as well as in asset maintenance and improvement.

Determined, as ever, to uphold our leadership in the power industry, we have decided to target three main avenues that will guide our actions in the coming years: energy efficiency, complementary development of hydroelectricity and wind power, and technological innovation.

An effective strategy for meeting growth in domestic demand

One of the year's pivotal events was that demand in Québec exceeded the heritage pool. It reached a historic high of 169.2 TWh, driven mainly by a strong real estate market and a vigorous industrial sector. To meet the additional needs, Hydro-Québec Distribution turned to short-term markets. As indicated in the Electricity Supply Plan 2005–2014, our long-term supply agreements and the energy conservation efforts made by our customers should limit our use of short-term markets starting in 2007.

Hydro-Québec is a productive organization that listens to its customers, acts with leadership and transparency, and relies on proud, motivated employees.

Thierry Vandal
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Renewable energy

To satisfy needs on the domestic market, we rely on hydroelectricity and other forms of renewable energy, in keeping with our customers' expectations. In 2005, Hydro-Québec Distribution signed contracts for an initial block of 990 MW of wind power and issued a tender call for an additional 2,000 MW of wind power. To bring this power onto the grid, we are counting on both our ability to innovate and our robust transmission system. Because winds blow only intermittently, we have developed a generator balancing service authorized by the Régie de l'énergie. In addition, we are working to improve wind output forecasting methods in order to ensure optimal use of hydro and wind resources.

Committed to sustainable development

In response to various initiatives aimed at encouraging efficient power use, our customers achieved energy savings of nearly 450 GWh in the past year alone. This success prompted us to raise the 2010 target of the Energy Efficiency Plan by 37%. We are concentrating our efforts on initiatives that yield benefits for both the environment and our customers' pocketbooks.

An expanding generating fleet and transmission system

The commissioning of Toulnustouc generating station five months ahead of schedule was a highlight of the year. This approximately $1-billion, 526-MW facility will generate 2.7 TWh annually. In addition, we began work at the Chute-Allard and Rapides-des-Cœurs sites and continued construction at Mercier and Péribonka, as well as at Eastmain-1, where the reservoir began filling in November. All these projects are characterized by a spirit of respect for the environment and community concerns, and are generating substantial spinoffs throughout the province. Meanwhile, the $4.0-billion Eastmain-1-A/Sarcelle/Rupert project is currently at the environmental assessment phase.

Capital spending for the heavily solicited transmission system reached its highest level since the inception of Hydro-Québec TransÉnergie in 1997. The division invested $793 million in the system, including $336 million to meet demand growth.

Hydro-Québec Équipement and Société d'énergie de la Baie James, which manage the construction and refurbishment of generating and transmission facilities, recorded a total volume of activity of $2,059 million. Projects were tackled with might and main in an effort to move the schedules forward.

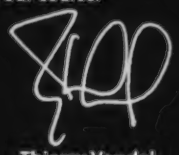
A boost for research and innovation

To improve our performance, we are counting on innovation and the potential of new electric technologies. We have reached an agreement with our researchers that will give new impetus to R&D efforts. This agreement should foster exchanges with industry and universities, and so enable us to join together in meeting the new technological challenges in the energy field.

Justifiable pride

We can look back with pride at the results we achieved in 2005. We met the challenges of ensuring energy security for the Québec market and increasing the capacity of our generating fleet. We reached these goals thanks to the outstanding contribution made by people with energy — people who put their heart and soul into their work, every day, and make Hydro-Québec a profitable, efficient company and a leader in its field.

We are also grateful to the experienced, competent individuals who make up the Board of Directors and who play an important part in steering our course.



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"The health and productivity of a hydroelectric generating station depend on effective and timely maintenance. Every day I try to find ways of working better. For example, I participated in a maintenance audit at Rapide-Blanc generating station that gave us an opportunity to study and improve our way of doing things. I'm totally invested in making sure the recommendations are applied."

Turning our energy into power and performance

Every day at Hydro-Québec Production, we strive to improve our performance and efficiency. This past year, our fleet's capacity grew with the commissioning of a new generating station, while construction continued at a steady pace at our jobsites. In addition, we carried out refurbishment work to ensure the reliability of our fleet and increase the generating capacity of some of our facilities. Altogether, $1,780 million was invested in these activities in 2005. By paying close attention to upkeep and maintenance, our crews enhance plant productivity and availability. We also carefully monitor our energy reserves to make sure we can meet all our contractual commitments inside and outside Québec, and we disclose information about our reservoir levels to guarantee transparency. In 2005, our revenue rose to $6.2 billion.

OUR MISSION

Hydro-Québec Production generates electricity and sells it on wholesale markets both inside and outside Québec.

OUR FACILITIES

Our generating fleet comprises 53 hydroelectric generating stations, 4 conventional thermal generating stations, 1 nuclear generating station and 1 wind farm. It has a total installed capacity of 34 GW and represents assets of $23 billion. We also have 25 large reservoirs with a storage capacity of 172 TWh, and over 540 dams and control structures.

OUR ACTIVITIES

We supply Hydro-Québec Distribution with a heritage pool of up to 165 TWh of electricity per year, at an average price of 2.79¢/kWh. Above this volume, we compete freely in selling our output on domestic and external markets, in response to calls for tenders or on short-term markets.

2005 IN FIGURES

Revenue	$6.2B
Net income	$1,873M
Customers (% of revenue from electricity sales)	
Hydro-Québec Distribution	75%
Other wholesale markets	25%
Sales volume	
Hydro-Québec Distribution	165.1 TWh
Other wholesale markets	16.0 TWh
Property, plant and equipment as at December 31 (including work in progress)	$26.6B

Richard Cacchione
President, Hydro-Québec Production

Our successes are built on the competence, sense of responsibility and determination of all the employees at Hydro-Québec Production.

Creating value

Our wholesale operations benefited from favorable market conditions, and we were able to seize business opportunities on markets outside Québec in addition to supplying the domestic heritage pool. As a result, net income was up 13% from last year.

The flexibility of our generating fleet, which uses water to produce 97% of its output, allows us to import electricity when prices are low and export it when prices are higher. We also conduct profitable arbitrage and purchase-resale transactions on markets outside Québec.

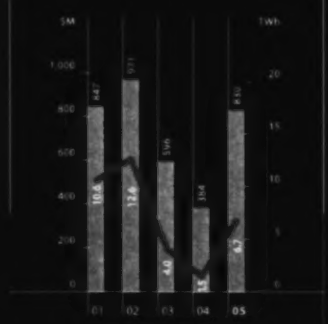
- Net income was $1,873 million, compared to $1,661 million in 2004. This increase is mainly attributable to sales on export markets.
- Sales of power outside Québec generated $1,464 million for 15.3 TWh in 2005, up from $1,084 million for 14.4 TWh in 2004. Taking short-term purchases into consideration, net electricity exports and the related financial transactions generated $830 million, for net reservoir drawdown of 6.7 TWh, compared to $384 million and 1.5 TWh last year.
- Our sales to Hydro-Québec Distribution totaled 165.1 TWh, versus 165.3 TWh in 2004.
- As at December 31, 2005, our reservoir level represented 105.3 TWh, compared with 101.9 TWh at the end of the previous year. In 2005, runoff was slightly in excess of the historic mean.
- We manage our reservoirs in such a way as to maintain a sufficient reserve at all times to offset a potential runoff deficit of 64 TWh over two consecutive years and 98 TWh over four consecutive years. We also keep enough capacity reserve — approximately 10% more than our contract commitments — to comply with the industry's current reliability criteria.

Developing Québec's hydropower potential

Hydroelectric development made steady progress in 2005. At December 31, we had projects worth $4.4 billion under construction, for an installed capacity of 1,054 MW and annual output of 6.1 TWh.

The average cost of a kilowatthour in 2005 was 1.9¢, which corresponds to the sum of the Generator's production and supply costs divided by the net sales volume.

Net Electricity Exports



Net contribution including revenue from energy-related derivative instruments

Net reservoir drawdown

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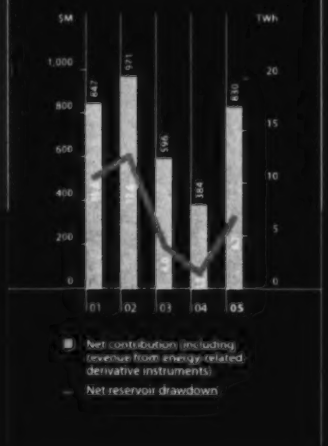


We are continuing to develop Québec's hydroelectric potential with a view to meeting demand growth.

- Toulnustouc, commissioned five months ahead of schedule, added 526 MW to our installed capacity and 2.7 TWh to our annual output. This $1-billion facility will contribute to optimizing the Manicouagan complex.

- Located on the Gatineau River at the outlet of Baskatong reservoir, Mercier generating station is slated for commissioning in 2006. This 51-MW facility will add 0.3 TWh in annual output, at a cost of $140 million.

- In the James Bay region, we continued work on the $2.2-billion, 480-MW Eastmain-1 development, slated for commissioning in 2006 and 2007. It will generate 2.7 TWh annually.

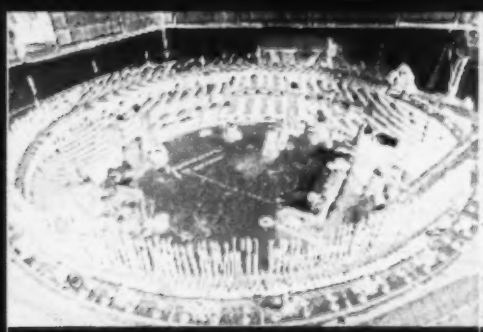
- On the Péribonka River, we are investing $1.4 billion to build a 385-MW generating station that will come on stream in 2008 and produce 2.2 TWh per year.

- In May, we broke ground on the Chute-Allard and Rapides-des-Cœurs developments on the Saint-Maurice River. With a combined installed capacity of 138 MW and annual output of 0.9 TWh, the facilities will cost an estimated $0.7 billion. They are scheduled for commissioning in 2007 and 2008.

- In December 2004, we submitted an approximately 2,500-page environmental impact statement on the Eastmain-1-A/Sarcelle/Rupert project, together with 35 background studies, to the federal and provincial review bodies for approval. Then, in 2005, the review bodies requested additional information, which we provided; they issued the notice of compliance in January 2006 and announced public hearings starting March 15. If construction begins as scheduled in late 2006, the diversion and production facilities will come on line in stages from 2009 to 2012. At a total cost of $4.0 billion, this is "the hydropower project of the decade" in Québec. Ultimately, it will add 888 MW in capacity and 8.5 TWh in annual output.

- Technical surveys for the planned Romaine hydroelectric complex are nearing completion, and the project is now in the design optimization stage. Draft-design studies for this approximately 1,500-MW complex should be finished in 2006.

- As regards the development of the Lower Churchill River, with hydroelectric potential estimated at 2,800 MW, the Government of Newfoundland and Labrador received 25 proposals and selected three for further study, including the joint proposal submitted by Hydro-Québec, the Ontario government and SNC-Lavalin.



Beauharnois generating station is the site of major refurbishing work.

Toulnustouc hydroelectric development.

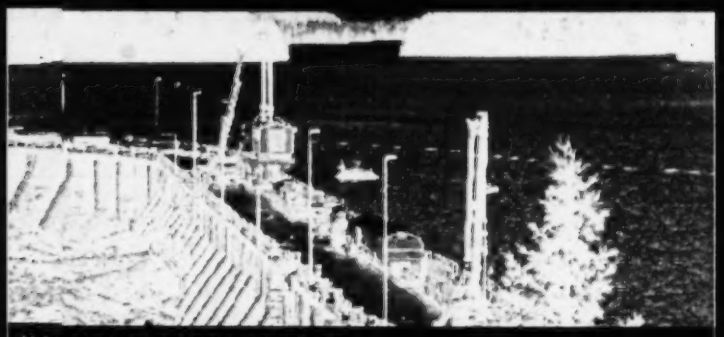
All our projects comply with the conditions we have set: they must be profitable, environmentally acceptable and favorably received by local communities.

Ensuring the long-term operability of our fleet

In 2005, we invested $446 million in refurbishing our facilities to ensure their long-term operability and, in some cases, to increase their generating capacity. Optimizing our assets is contingent on in-depth knowledge of the condition of our fleet and its upgrade potential. Our employees' expertise and commitment help us achieve this.

As the world leader in hydroelectric generation, we operate assets valued at $23 billion.

- Refitting now under way at Outardes-3 and Outardes-4 will add 310 MW in capacity by 2008.
- Refurbishment continued at Beauharnois, where annual output will increase by 170 GWh once the work is completed in 2016.
- Phase II in the refurbishment of La Tuque generating station got under way in 2005. Refitting the last three generating units will add 51 MW in installed capacity, bringing the total to 271 MW.
- Refurbishing continued at Rivière-des-Prairies, Rapide-2, Rapide-7 and Rapides-des-Quinze with a view to ensuring reliability and long-term operability.
- Refurbishment work was done on Mercier, Coteau-1, Coteau-3 and Île-Juillet dams.
- The permitting process and draft-design studies continued on the project to modify the radioactive waste storage facilities at Gentilly-2 nuclear generating station and refurbish the plant.

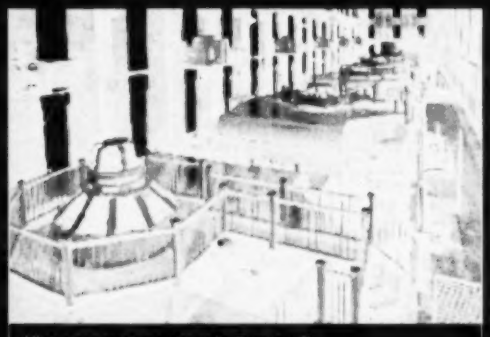


Major refurbishment at Rapides-des-Quinze.

Making use of technological innovation

To achieve our goals, we also rely on innovation. The Technology Group is in charge of a portfolio of generation projects worth over $11 million.

In 2005, three major projects made great strides. Using the MATH simulation technology and the Scompi robot in tandem improved the precision and speed of turbine alterations at Manic-3. When complete, the modification of four generating units here will yield savings of $10 million, additional capacity of 7.5 MW and additional output of 1 GWh. Several years of research have culminated in an industrial version of the MASKI underwater robot. This device, the only one of its kind, is used to inspect dams under difficult and dangerous conditions; its operations can be controlled with an extraordinary degree of precision. And at Gentilly-2 generating station, we began using the REC robot, which is faster and more flexible than its predecessor, to inspect heat exchangers.

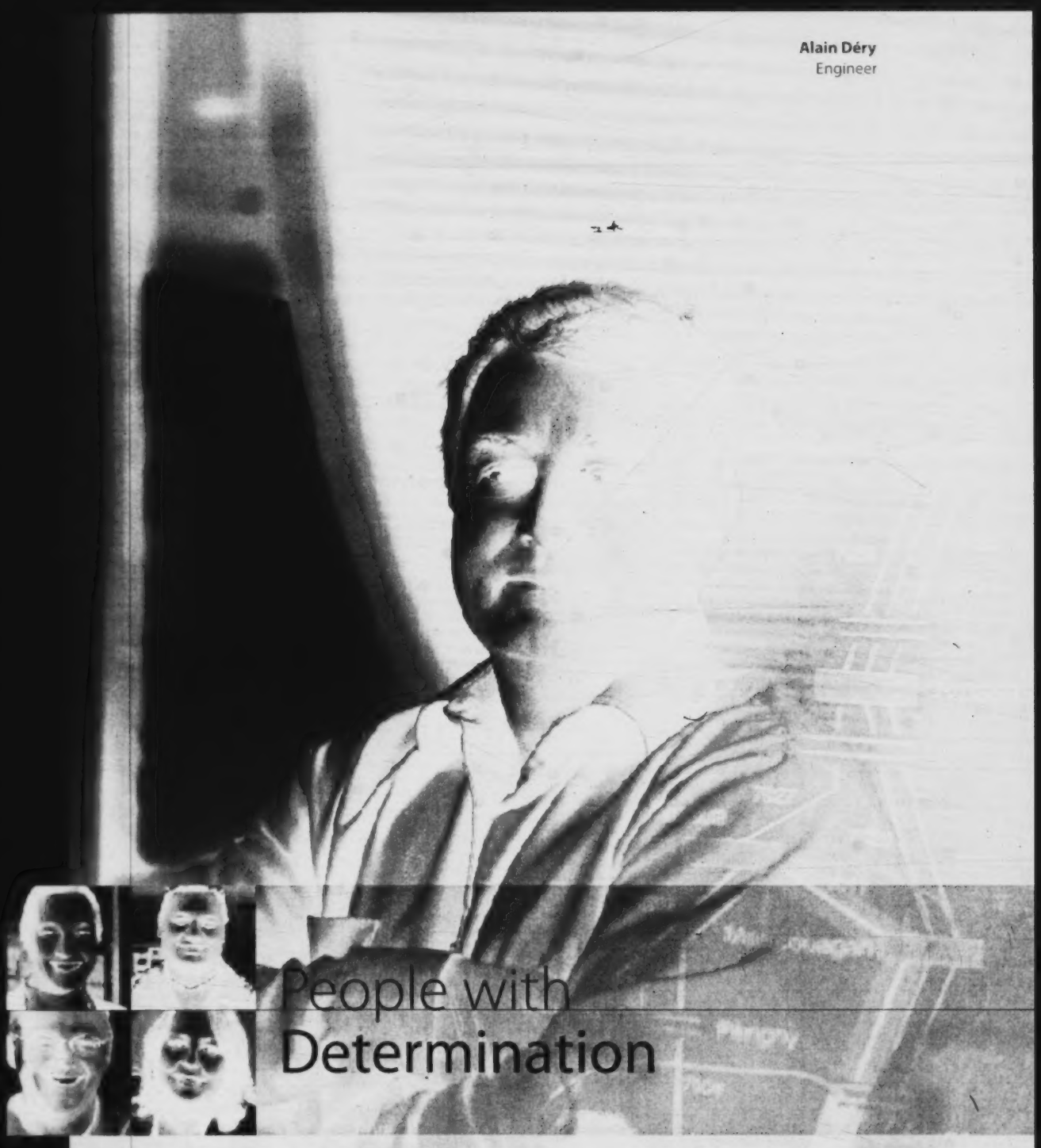


All the generating units at La Tuque will be upgraded by the end of 2008.

Alain Déry
Engineer

People with Determination

"I'm proud to have proposed a way to protect 735-kV lines in the Québec City region against the kind of ice loading we had in 1998. The de-icing system recently installed at Lévis substation uses direct current to raise the temperature of the conductors enough to melt the ice."



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Building and maintaining a reliable grid

Hydro-Québec TransÉnergie has some sizable challenges to meet, which are posed by growth in demand, the connection of new generating stations and the upcoming delivery of a large block of wind power. We are consequently investing in efforts to increase system capacity, upgrade various facilities in preparation for bringing wind power onto the grid, and modernize data acquisition and remote control systems.

In 2005, we invested $793 million to ensure the growth, maintenance, improvement and security of our assets, up from $586 million last year, and the largest amount since the division was created in 1997. Our capital investment program will enable us to meet increased demand in the coming years.

Our employees' expertise is also key. In April, for example, a major ice storm accompanied by strong winds damaged three 735-kV lines on the North Shore. Our crews solved the problem without any service interruptions and rebuilt the damaged sections to design criteria that increased their ability to withstand severe weather conditions.

OUR MISSION

Hydro-Québec TransÉnergie operates the most extensive transmission system in North America. It transmits electricity and markets system capacity, while maintaining the necessary standard of reliability.

OUR FACILITIES

The transmission system comprises 32,544 km of lines, 505 substations and a large number of interconnections with the systems in New Brunswick, Ontario and the U.S. Northeast.

OUR ACTIVITIES

In compliance with North American regulatory provisions, we offer non-discriminatory access to our system to all customers on the wholesale market in northeastern North America.

2005 IN FIGURES

Revenue	$2.6B
Net income	$369M
Customers (% of revenue)	
Hydro-Québec Distribution (transmission service)	90%
North American wholesalers (transmission service)	4%
Other	6%
Property, plant and equipment as at December 31 (including work in progress)	$15.3B
Regulatory regime	Cost-based

Yves Filion
President, Hydro-Québec TransÉnergie

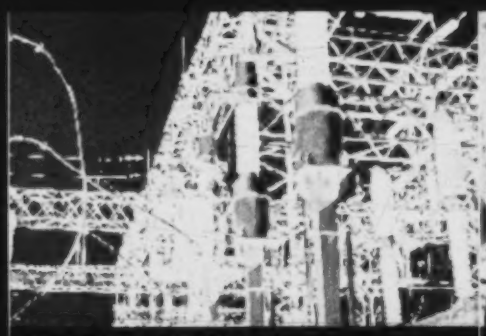
Backed by solid know-how, we ensure reliable, high-quality power transmission in Québec.

Transmitting more and more power

We are meeting the challenge of responding to the growing demand for our power transmission service. We worked on even more projects than last year to increase system capacity, for a total of $153 million. We also stepped up our capital program designed to yield greater operating flexibility during peak periods. We finished connecting several new facilities to the grid, and are proceeding with other similar projects. We also embarked on work to strengthen the system in preparation for deliveries of wind power.

By investing in the system, we ensure that we have the capacity and the means to meet users' needs.

- We increased transformer capacity at 11 satellite substations.
- A 120-kV line now runs between Langlois and Dorion substations.
- Since the fall, Bergeronnes substation has been ready to receive the output of the new Toulnustouc generating station as well as additional power from Outardes-3 and Outardes-4 once their refitting is completed.
- Work to bring the future Mercier generating station onto the grid was completed.
- A $50-million project to build a 315-kV line linking Nemiscau substation and the future Eastmain-1 powerhouse is under way.
- We also carried out a $32-million project to increase transformer capacity at Arnaud substation in order to handle Phase II of the Alouette aluminum smelter.
- With a view to connecting the future Peribonka generating station to the transmission system, we carried out public consultations and mapped out the line route. This project will have a total cost of $185 million.
- As for the Chute-Allard and Rapides-des-Cœurs developments, we are awaiting permits to construct the transmission facilities related to this $105-million project.
- In order to bring the wind farms planned in the Gaspé region onto the grid, we are reinforcing protection systems and have modified the 230-kV line connection to Les Boules substation.



Mercier substation is ready to meet new operating requirements.

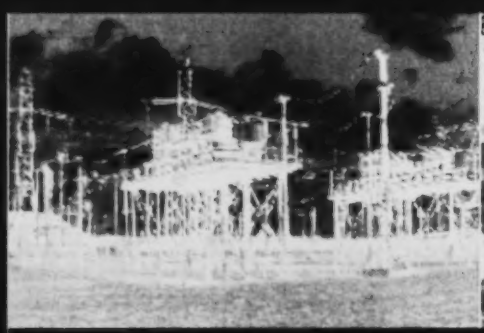
Transmission capacity has doubled at L'Acadie substation.

Continually improving the transmission system's reliability

We devoted $457 million to maintaining and improving our transmission fleet. We plan our maintenance activities on the basis of strict monitoring criteria. As part of our quality improvement programs, we are also continuing to strengthen the transmission system to ensure its reliability in case of extreme weather events.

The growing volume of electricity to be transmitted creates pressure on the system and requires facilities to be more available.

- We finished refurbishing the control and protection systems at Boucherville substation.
- Engineering work was completed on the first compensator to be used to de-ice 735-kV lines. This equipment will be installed at Lévis substation, near Québec City, and is scheduled for commissioning in 2006.
- At a cost of $14 million, we rebuilt two sections of 735-kV lines on the North Shore that had been damaged by an ice storm in April. These sections now have better resistance to adverse weather conditions.
- We rebuilt a 120-kV tie line between Lanaudière and Ramezay substations and increased its ice-loading strength.
- We filed an application that includes a plan for reinforcing the regional systems. The plan provides for approximately $375 million in work, to be carried out between 2006 and 2015.



Bergeronnes substation can now handle the additional megawatts generated by Toulnustouc and other facilities.

Nemiscau substation, which will be linked to Eastmain-1 powerhouse by a 315-kV line.

Ongoing technological progress

Digital technology shows great potential in the transmission field, and we have begun developing state-of-the-art solutions in this area. Our transmission system, one of the most automated in the world, will soon be equipped with new, high-performance control and management tools, which will enable us to react faster and more effectively to unforeseen events. Modernization of the telecommunications network management system also got under way this year. In short, we are maintaining the technological edge that ensures efficient transmission and has earned us a reputation as a leading innovator.

We are upgrading our management systems to increase the stability and reliability of the power grid.

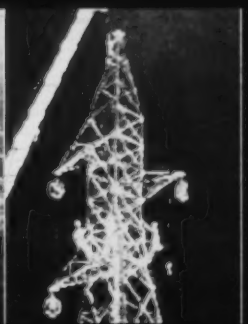
- We continued making improvements to the telecommunications network by digitizing the Rouyn–Abitibi and Boucherville–Beauharnois links. In preparation for wind power integration, we commenced work to loop the telecommunications network on the Gaspé Peninsula by means of fibre-optic links on the north side and digital microwave links on the south side.

- This year, we installed the system for remote load-shedding control known as CADRE. When a service interruption occurs, CADRE provides a real-time picture of the load available at a given substation and keeps an up-to-date list of customers' supply needs, in order of priority. As well, we continued the process of replacing our remote control operating software. The new GEN-4 SCADA system was successfully installed at the Trois-Rivières telecontrol centre.

- We lowered power system voltage on a trial basis, with the aim of reducing the load at peak periods. If the results are positive, this technique will enable system operators to seek out other power sources in order to maintain operating reserves above the set thresholds.

We are responsible for the safe operation of the transmission system in the Québec Control Area, in accordance with the stringent reliability standards of the North American Electric Reliability Council and the Northeast Power Coordinating Council.

A high-voltage line de-icer will soon be installed at Lévis substation.



The Lanaudière–Ramezay line is now better able to withstand ice loading.

Strictly regulated operations

Energy transmission in Québec is regulated by the Régie de l'énergie on the basis of cost of service. Like our investments, our terms of service must be approved by the Régie.

The revenue authorized must cover all costs and allow a reasonable return on shareholder's equity.

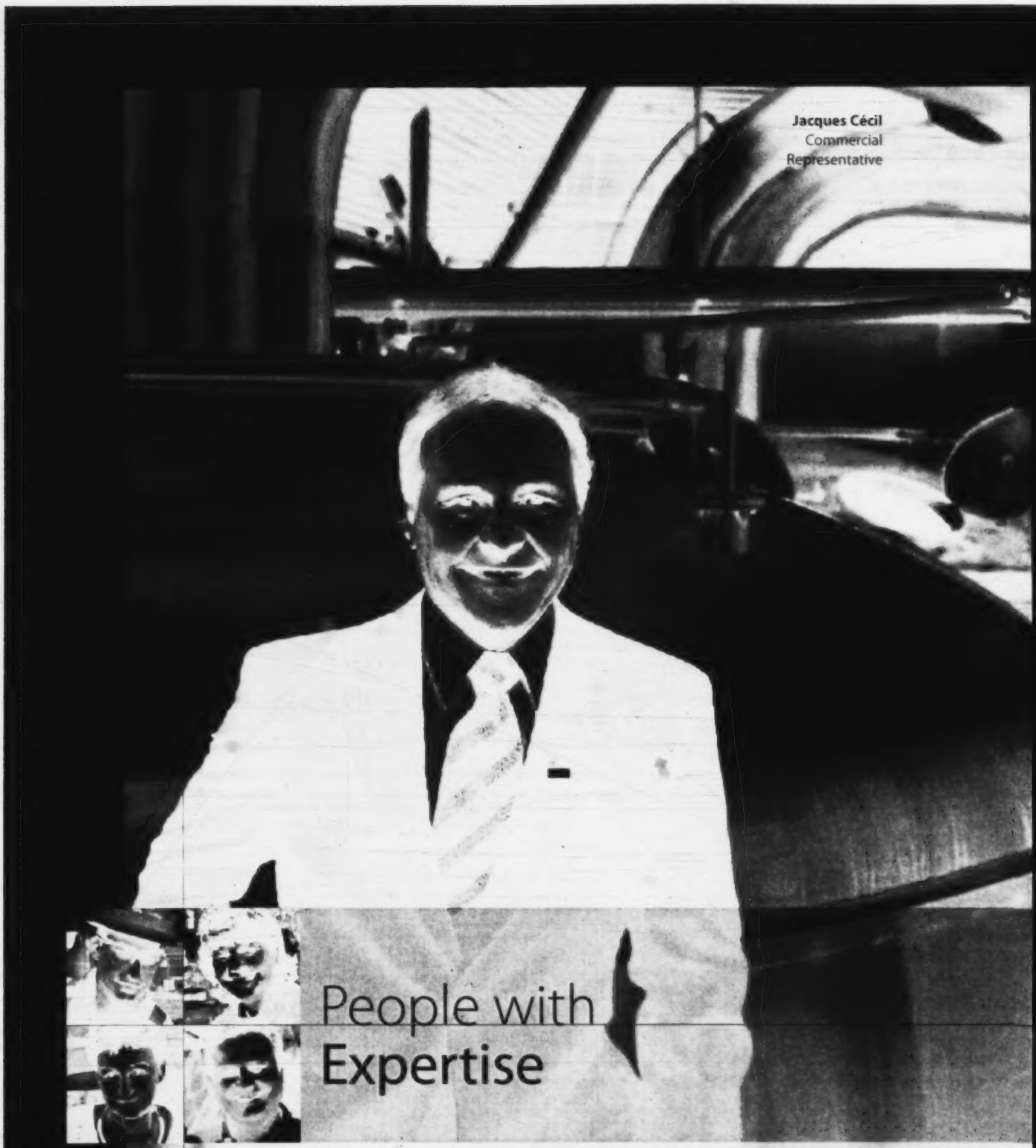
- Work on the rate case seeking an amendment of the terms of transmission service continued in 2005. In April, the Régie authorized total revenue of $2,591 million. In June, we filed an application concerning the allocation of the authorized revenue among the various customer categories.
- We received Régie approval to invest $550 million in 2005 in development projects costing less than $25 million each.

A changing transmission system

In 2005, we produced a technological evolution plan for 2007–2016, which covers the technological changes being considered to upgrade the system and thereby increase its reliability, service life and transmission capacity. It includes a number of new features, such as bringing wind output onto the grid.

Among our many research projects in 2005, we began automating system management by means of intelligent controls and secure systems for remote information access. A pilot remote maintenance project, intended to optimize use of the various system components, is under way at Frégeau substation in the Mauricie region. The hardware and software infrastructure is in place, and the remote parameterizing and diagnostic interface will be installed shortly. In addition, we defined the requirements and technological architecture of a model remote maintenance centre. This centre represents one of the first steps toward implementing a highly efficient automated management technique.

We continued our technological evolution plan for Hypersim, a real-time digital power system simulator. Among other developments, we have sold this software to China and Korea, where it will serve to validate control and protection systems. It will also be used for studies on the integration of wind power and other generating sources.



Jacques Cécil
Commercial
Representative

People with Expertise

"I act as an advisor to about 20 major companies, helping them reduce production costs. One solution I always propose is to optimize electricity consumption. To date, over 65% of the customers I work with have signed up for one of our energy efficiency programs. For example, a major Montréal brewery cut back its power use by 9%, which earned it a certificate from our Energy Savers' Circle."

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Sparing no effort to satisfy our customers

The measures we have put in place in recent years have enabled us to ensure security of supply and meet the high growth in demand. Moreover, we have undertaken to diversify our sources of supply through a strategy that promotes renewable energy — and wind power in particular — in keeping with customer expectations. At a time of steeply rising energy prices, we are more active than ever in advocating judicious electricity consumption. In fact, the initial results of our Energy Efficiency Plan have led us to raise our target by more than a third. We also completed the first major stage in the CIS (Customer Information System) project, designed to modernize the business procedures and information systems related to customer services. At the same time, we undertook a revision of the terms and conditions of electricity service to better serve our customers. These are all major challenges which we are meeting with determination and ingenuity.

OUR MISSION

Hydro-Québec Distribution ensures a secure power supply for Quebecers and a reliable distribution system. It provides customers with quality services tailored to their needs. To encourage responsible electricity consumption, it also has energy efficiency programs for all customer categories.

OUR ACTIVITIES

To serve the domestic market, we rely primarily on the heritage pool of 165 TWh of electricity which Hydro-Québec Production is obliged to supply. When demand exceeds this volume, we purchase electricity on the open market. We ensure that the distribution system operates efficiently at all times.

OUR FACILITIES

We have 108,344 km of lines, a Call Centre set up in nine locations, a Customer Relations Centre that offers on-line services accessible 24/7, and five distribution control centres.

2005 IN FIGURES

Revenue	$9.2B
Net income	$230M
Customers (% of revenue)	
Markets subject to the *Rates Bylaw*	93%
Special contracts	6%
Other	1%
Property, plant and equipment as at December 31 (including work in progress)	$8.2B
Regulatory regime	Cost-based

In a rapidly changing environment, we must satisfy our customers' needs at the lowest possible cost.

André Boulanger
President, Hydro-Québec Distribution

Ensuring security of supply

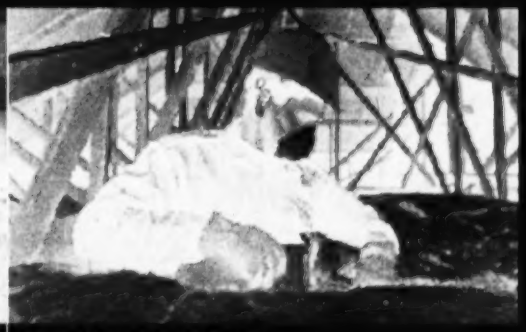
Demand exceeded the heritage pool of 165 TWh in 2005. To deal with this growth, we optimized the use of heritage pool electricity and made additional purchases of power. Our supply costs increased because of the high price of electricity on the open market. The higher supply costs constitute an important factor underlying rate increases.

Our priority: provide Quebecers with a secure supply of electricity at the lowest cost.

- On April 1, 2005, our rates increased by an average of 1.2%.
- On October 5, the Régie approved the Electricity Supply Plan 2005–2014. Two weeks later, we filed our first progress report on the plan.
- Also in October, we issued a call for tenders for the purchase of an additional 2,000 MW of wind power, as ordered by the Québec government. Deliveries are to begin in 2009.
- To respond to very short-term needs, which are liable to fluctuate unpredictably because of the vagaries of the weather, we signed a framework agreement with Hydro-Québec Production that was approved by the Régie in November.
- In July, the Régie approved the contracts signed with Cartier Wind Energy and Northland Power for the supply of 990 MW of wind power.
- We asked the Régie to authorize a contract with Tembec for the supply of 8.1 MW of electricity generated from forest biomass starting in December 2008.
- In February 2006, the Régie approved an agreement with Hydro-Québec Production on the integration of wind power into the system.

We meet the needs of the domestic market while promoting responsible use of electricity.

Wind power is a key component of our energy supply.



Energy efficiency: an ecologically responsible choice.

Listening to our customers

We do our utmost to fulfill our customers' expectations. Accordingly, in view of the early success of the Energy Efficiency Plan, we raised our target and are now aiming for energy savings of 4.1 TWh by 2010, an increase of 1.1 TWh. This collective effort offers the twofold advantage of limiting demand growth and reducing our supply costs.

Serving our customers better is also the object of the Customer Information System (CIS) project launched in 2003. The goal of this project is to modernize all processes and information systems related to sales and customer services. Designed to provide a comprehensive overview of customer files, the CIS will facilitate the exchange of information between units and thereby enable us to improve our efficiency.

RESIDENTIAL, COMMERCIAL AND BUSINESS CUSTOMERS

Our focus: energy efficiency.

- The satisfaction index for residential customers remained the same as in 2004: 7.3 out of 10. The index was also stable for commercial (7.3) and business (7.2) customers.
- In December, we rolled out the commercial and business customer portion of the CIS.

The Bibby Ste-Croix foundry, a new member of our Energy Savers' Circle.

The Molson brewery also received a certificate of participation in the Energy Savers' Circle. From left to right: Thierry Vandal, President and Chief Executive Officer, Hydro-Québec; Benoît Maillette, director, and Richard Morin, manager, thermal plant, Montréal brewery, Molson Canada; and André Boulanger, President, Hydro-Québec Distribution.

- The residential, commercial and business customer categories responded favorably to the energy efficiency programs offered under the ENERGY WISE banner. A total of nearly 300 GWh in energy savings was achieved in 2005.

  - Residential customers completed more than 263,500 Home Diagnostic questionnaires in 2005. Our program promoting efficient products, which focused mainly on electronic thermostats and pool filter timers, was also an undeniable success. In 2006, we plan to promote household appliances and lighting products that meet ENERGY STAR® specifications.

  - Business customers submitted 366 projects under the Empower Program for Building Optimization. Of this total, 113 were completed, and the efficiency measures implemented have generated savings of 29 GWh. The Empower Program for Industrial Systems elicited 95 projects, yielding 40 GWh in savings. This program offers financial support and other tools to small and medium-sized businesses to help them to adopt energy efficiency measures. The Efficient Products Program, launched in 2005, provides rebates on alternative electrical products chosen for their energy performance.

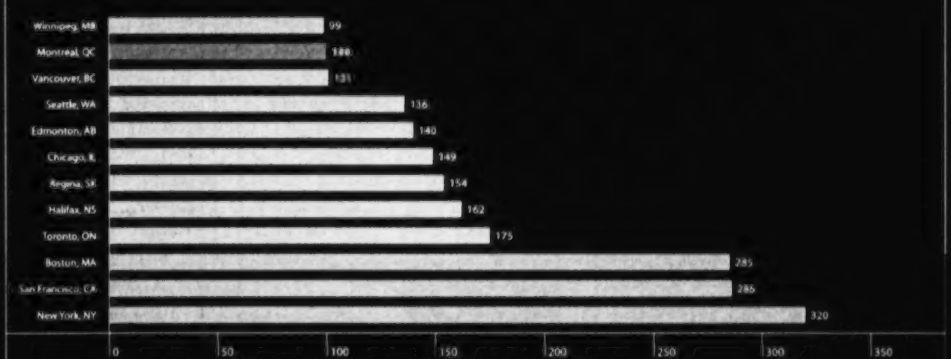
  - We kept up our support for government energy efficiency programs for residential customers, including Novoclimat and the Program for Low-Income Households, both offered by the provincial Agence de l'efficacité énergétique (AEE), and the EnerGuide for Houses program, offered by the federal Office of Energy Efficiency in partnership with the AEE. In 2005, these programs generated an estimated 24 GWh in savings.

- To better focus on our core operations and on promoting energy conservation, we sold our subsidiary HydroSolution, Limited Partnership, which specialized in the leasing, sale and installation of water heaters, home heating systems and air conditioners, to the Gaz Métropolitain Plus consortium. The transaction yielded a gain of $48 million.

- We reached more than 20,000 arrangements, worth $17.6 million altogether, with low-income customers who are having trouble paying their bills. These arrangements allow them to pay back their debts over a longer period, without administrative fees. As well, in cooperation with 25 consumer associations, we pursued an initiative to develop services that are even better suited to these customers' circumstances.

® ENERGY STAR is an official trademark, used under licence.

Comparative Index of Electricity Prices at April 1, 2005
Residential Customers[a]



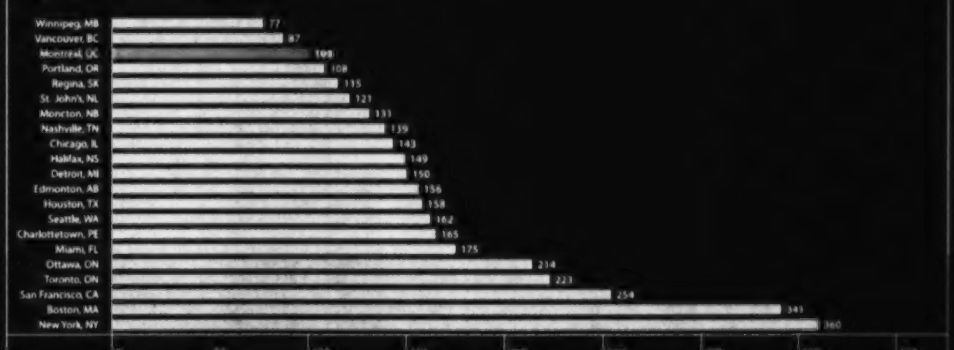
a) Monthly bill (before taxes) for a consumption of 1,000 kWh.

LARGE-POWER CUSTOMERS

We maintain close business relations with industrial, commercial and institutional customers who have a power demand of 5 MW or more. This category alone consumes 42% of the electricity distributed in Québec.

- The satisfaction index for large-power customers reached 9.1 out of 10.
- The two energy efficiency programs introduced in 2003 for large-power customers continued to yield better-than-expected results. Approximately 45% of customers have taken part so far, and 115 projects that have generated savings of about 144 GWh started up in 2005. The Industrial Initiatives Program offers financial support for projects designed to reduce specific electricity consumption. And through the Industrial Analysis and Demonstration Program, customers can obtain financial assistance for energy analyses or projects to demonstrate new energy-saving technologies not yet implemented in Québec.
- Two new energy efficiency programs for large-power customers were submitted to the Régie de l'énergie for approval. The Plant Retrofit Program is for industrial companies that wish to significantly reduce their facilities' overall electricity consumption. The Building Initiatives Program, designed for commercial and institutional customers, offers financial assistance for energy analyses or projects to optimize electricity consumption.
- After signing an initial agreement for energy efficiency cooperation with the Aluminum Association of Canada, we reached similar agreements with the BOMA Québec Building Owners and Managers Association, the Québec Forest Industry Council, the Association minière du Québec and the Association québécoise des consommateurs industriels d'électricité.

Comparative Index of Electricity Prices at April 1, 2005
Large Power Customers[a]



a) Monthly bill (before taxes) for 50 MW of power at 120 kV and a consumption of 30,600 MWh.

Modernizing the distribution grid

We are continually integrating new technologies to improve the efficiency of our distribution grid. In 2005, we implemented a georeferenced system as well as a remote control system that is the first step toward distribution system automation. These initiatives will enable us to improve service quality and continuity.

Our goal: improve service continuity

- The average number of hours of service interruption per customer stood at 2.4.
- Customer satisfaction with information provided in the event of power failures held steady at 7.2 out of 10, and more than 85% of our customers were notified in advance of any scheduled outage.
- Nearly 80% of new hookups were completed on schedule — quite an accomplishment considering the sizable increase in the number of new accounts.
- In July, the Régie de l'énergie authorized Phase I of the distribution system automation program. Automation will improve service quality by reducing the number of hours of interruption in particularly high-risk areas. Under this program, we began rollout of a remote control system that will cover approximately 3,750 circuit breakers and switches by 2011.
- We began deploying the Dcartes system. This georeferenced system will allow us to view the entire distribution system on a continuous map base. The goal is to standardize processes, optimize facility design and facilitate decision making.
- We invested $8 million in the grid reinforcement program. Since 1999, we have spent $139 million on measures to protect against ice loading.

To reduce the impact on our customers, a lot of our work is done at night.

Research that benefits our customers

Naturally, energy efficiency is one of our most important fields of research. In 2005, a line of electric thermal storage systems that Hydro-Québec's energy technologies laboratory (LTE) adapted to meet the needs of our business customers reached the marketing stage. These systems store heat during low-consumption (off-peak) periods and then release it when power demand is high. The largest model can deliver as much as 80 kW over eight consecutive hours. Heating by means of electric thermal storage presents an attractive potential for energy savings and supply during peak periods.

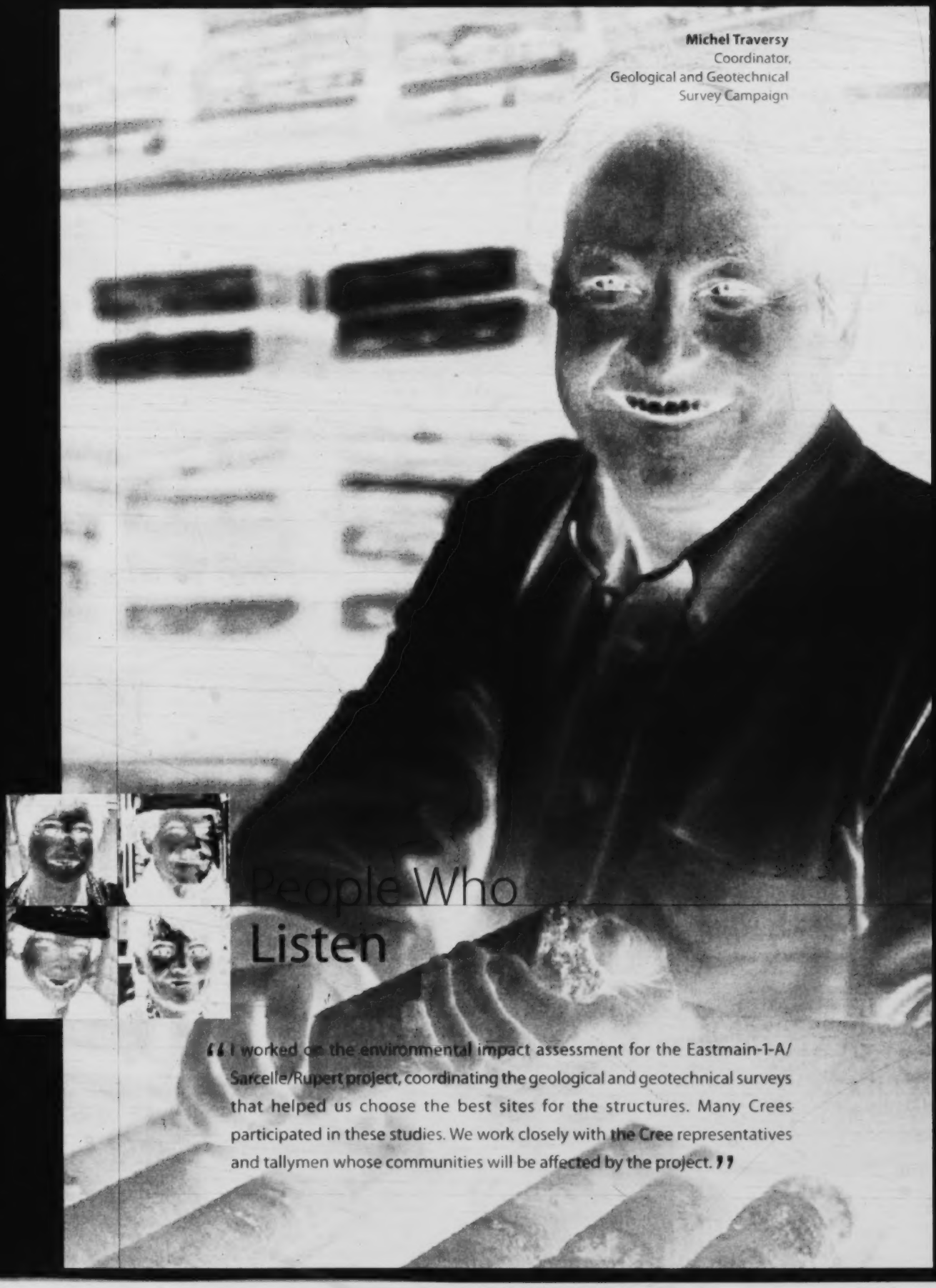
Customer accounts increased by more than 50,000 this year.

Alain Moreau, Researcher. Using a brick to store heat is a very old principle that inspired the electric thermal storage system designed for our business customers.

Michel Traversy
Coordinator,
Geological and Geotechnical
Survey Campaign

Who Listen

"I worked on the environmental impact assessment for the Eastmain-1-A/Rupert project, coordinating the geological and geotechnical surveys that helped us choose the best sites for the structures. Many Crees participated in these studies. We work closely with the Cree representatives and tallymen whose communities will be affected by the project."



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Men and women at work

This past year was one of intense activity. With jobsites totaling $2,059 million, or almost 5% more than last year, our order book included major projects that were carried out within budget and on schedule, overall, in spite of complex and challenging technical and market conditions. The commissioning of Toulnustouc five months ahead of schedule ranks as one of our key accomplishments for the year. Two project sites hit some milestones as well: impoundment of the reservoir that will supply Eastmain-1 powerhouse and the installation of the foundation for Péribonka dam. We also broke ground on the Chute-Allard and Rapides-des-Cœurs hydroelectric developments, and connected Toulnustouc generating station to the transmission system, which also underwent some reinforcement work. In addition, we embarked on a program to increase security at Hydro-Québec Production and Hydro-Québec TransÉnergie facilities. This work will conclude in 2007.

OUR MISSION

Hydro-Québec Équipement and Société d'énergie de la Baie James carry out engineering and construction work for hydroelectric developments in Québec. Hydro-Québec Équipement also builds transmission lines and substations.

OUR ACTIVITIES

We look after every stage in the development of generating and transmission facilities, from draft-design studies and engineering to project management to construction and commissioning. We are constantly seeking ways to reduce project costs and lead times, while delivering high-performance facilities. We ensure that every project is profitable, environmentally acceptable, and favorably received by local communities. We work actively with our partners in the communities and in industry.

2005 IN FIGURES

Volume of activity	$2,059M
Main customers (% of volume)	
Hydro-Québec Production	69%
Hydro-Québec TransÉnergie	30%
Other	1%

Our high-calibre expertise, our innovative ability and our practical know-how are what enable us to deliver reliable generating and transmission facilities to our customers at competitive prices.

Réal Laporte
President, Hydro-Québec Équipement
President and Chief Executive Officer,
Société d'énergie de la Baie James

Mission accomplished

Toulnustouc, a project for which partnership agreements were signed with the Betsiamites Band Council and the regional county municipality of Manicouagan, is a new addition to the Manicouagan complex. The first new facility completed in the current wave of major projects, this 526-MW generating station is the product of meticulous teamwork, as well as the unfailing commitment of our partners. But while it is the most impressive accomplishment of 2005, Toulnustouc is far from the only one.

Toulnustouc: 526 MW, 2.7 TWh

- Toulnustouc generating station started production in the summer. Since the beginning of construction in late 2001, it has generated regional spinoffs of $331.7 million. The dam is unusual in that the upstream slope is sealed with a watertight concrete facing, a technique used only once before in Québec. We also connected the generating station to Micoua substation at a cost of $129 million. This figure includes building a switchyard and an approximately 55-km, 315-kV single-circuit line.

Refurbishing

- We finished refurbishing at Rapides-des-Quinze, Bersimis-1, Manic-2 and Carillon generating facilities.

Commissioning

- The 120-kV Langlois–Dorion line, which crosses the St. Lawrence River, was commissioned as scheduled.

Emergency repairs

- We rebuilt 14 towers damaged by an ice storm on the 735-kV lines in the North Shore region, and we added five new ones to strengthen the system.

A remarkable range of generating projects

Our jobsites and planning rooms are the scene of intense activity focusing on construction and refurbishment projects. And we are actively planning new ones. In 2005, our volume of operations in this area totaled $1,425 million. Through practices built on partnering and being attentive to customer needs, and through action that is informed by flexibility, a sense of urgency and innovative skill, we are able to meet the technical and financial demands of the most complex undertakings.

At Toulnustouc: a generating unit is ready to go.

A 315-kV line links Toulnustouc generating station to Micoua substation.

Eastmain-1
480 MW, 2.7 TWh

- Construction is more than 75% complete at the Eastmain-1 site, where reservoir filling began on November 5. It took 32 dikes to close off the reservoir. In 2005, more than 2,600 workers were on the job here, 323 of them Crees. The generating station will be linked to Nemiscau substation by a 315-kV line currently under construction.

Péribonka
385 MW, 2.2 TWh

- Construction of the Péribonka development got off the ground with the temporary diversion of the river and installation of the dam foundation. Excavation of most of the structures, including the powerhouse, intake, penstocks and spillway, is now complete. The construction workforce reached its peak in November with over 1,000 workers. Economic spinoffs for the region have already surpassed $250 million, out of the $345 million anticipated. In addition, studies are under way for the construction of a 135-km, 161-kV line linking the generating station to Simard substation.

Mercier
51 MW, 0.3 TWh

- At Mercier generating station, construction of the powerhouse wound up in July. This facility will feature five generating units equipped with Saxo turbines, the first of their kind at Hydro-Québec. Commissioning is scheduled for 2006.

Chute-Allard and Rapides-des-Cœurs
138 MW, 0.9 TWh

- The initial stages of the Chute-Allard and Rapides-des-Cœurs developments got under way. Twelve generating units, each rated approximately 10 MW and equipped with Saxo turbines, will be installed. To bring the output onto the grid, we will build two 230-kV lines and two switchyards.

Outardes-3, Outardes-4 and La Tuque
361 MW in additional capacity

- Refitting and refurbishment continued at Outardes-3, Outardes-4 and La Tuque in 2005. Upon completion, this work will add 361 MW of capacity to our generating fleet.

- We continued refurbishment work at Beauharnois, Rivière-des-Prairies, Rapide-2 and Rapide-7.

Assembling a scroll case at Eastmain-1 powerhouse.

Over 320 Cree workers were employed on the Eastmain-1 site.

- Progress was made on two other major hydroelectric development projects currently on the drawing board.

  - The permitting process for the Eastmain-1-A/Sarcelle/Rupert project continued. We conducted field studies and new surveys in response to requests for additional information from the federal and provincial authorities. In January 2006, the authorities indicated that they considered the studies and answers submitted by Hydro-Québec to be acceptable. Public hearings will get under way on March 15, 2006.

  - In the case of the draft-design project for the Romaine complex, we optimized the design of the four developments and carried out technical and environmental surveys.

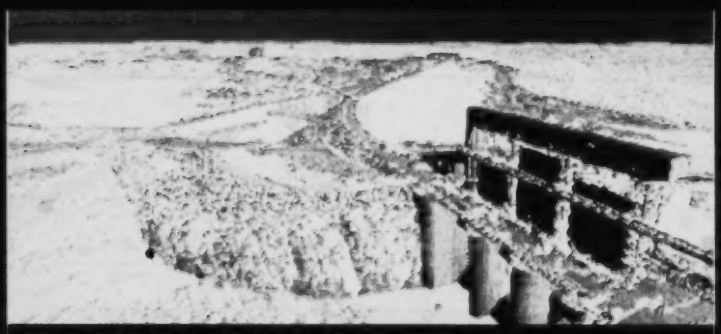
Contributing to transmission system performance

Our volume of transmission-related activity totaled $615 million in 2005, up from $427 million in 2004. We strengthened the system and helped Hydro-Québec TransÉnergie meet growing demand.

- Work to increase series compensation at Bergeronnes substation concluded this past fall. The substation can now handle generation from the new Toulnustouc facility as well as the additional output of the refurbished Outardes-3 and Outardes-4 generating stations.

- To bring the output from wind farms planned in the Gaspé region onto the grid, particularly those in Baie-des-Sables and L'Anse-à-Valleau, which are scheduled to start up in 2006, we modified the telecommunications network and automatic controls, and made changes to the lines and substations.

- To increase system capacity, we added power transformers in 11 substations. Many other projects of this type are in the startup phase.



Dam and spillway at the Eastmain-1 project.

Innovation: The key to our success, both present and future

From project conception to construction, we never stop exploring different options to reduce project costs and lead times, while ensuring the performance and reliability of the facilities we deliver to our customers.

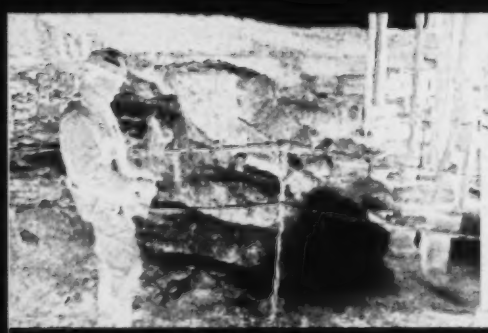
For our generating projects in 2005, we analyzed the possibility of prefabricating certain components to speed up plant construction and reduce costs and lead times, in particular for out-of-pit generator assembly for the Eastmain-1-A/Sarcelle/Rupert project.

A number of innovative approaches intended to mitigate environmental impacts are being developed for the Eastmain-1-A/Sarcelle/Rupert project. Building weirs along the Rupert River, for example, will prevent exposure of reduced-flow stretches. Moreover, the establishment of an ecological instream flow, which we developed using complex simulations, will be beneficial for the biological cycle of fish and will help preserve the various types of land and river use in the region once the project is complete.

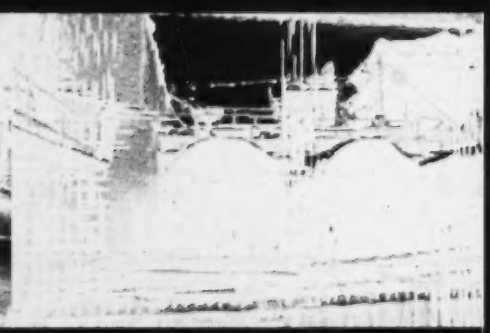
We designed 3D parametric models of all the earthfill and concrete structures at the future Romaine-1 project with a view to optimizing their construction.

In the area of transmission, we designed and laid easy-to-install 315-kV, cross-linked polyethylene cable at Québec and Lévis substations. This was the first time the manufacturer, Prysmian (formerly Pirelli), entrusted this task to a third party. We worked with them to train cable workers at Hydro-Québec TransÉnergie.

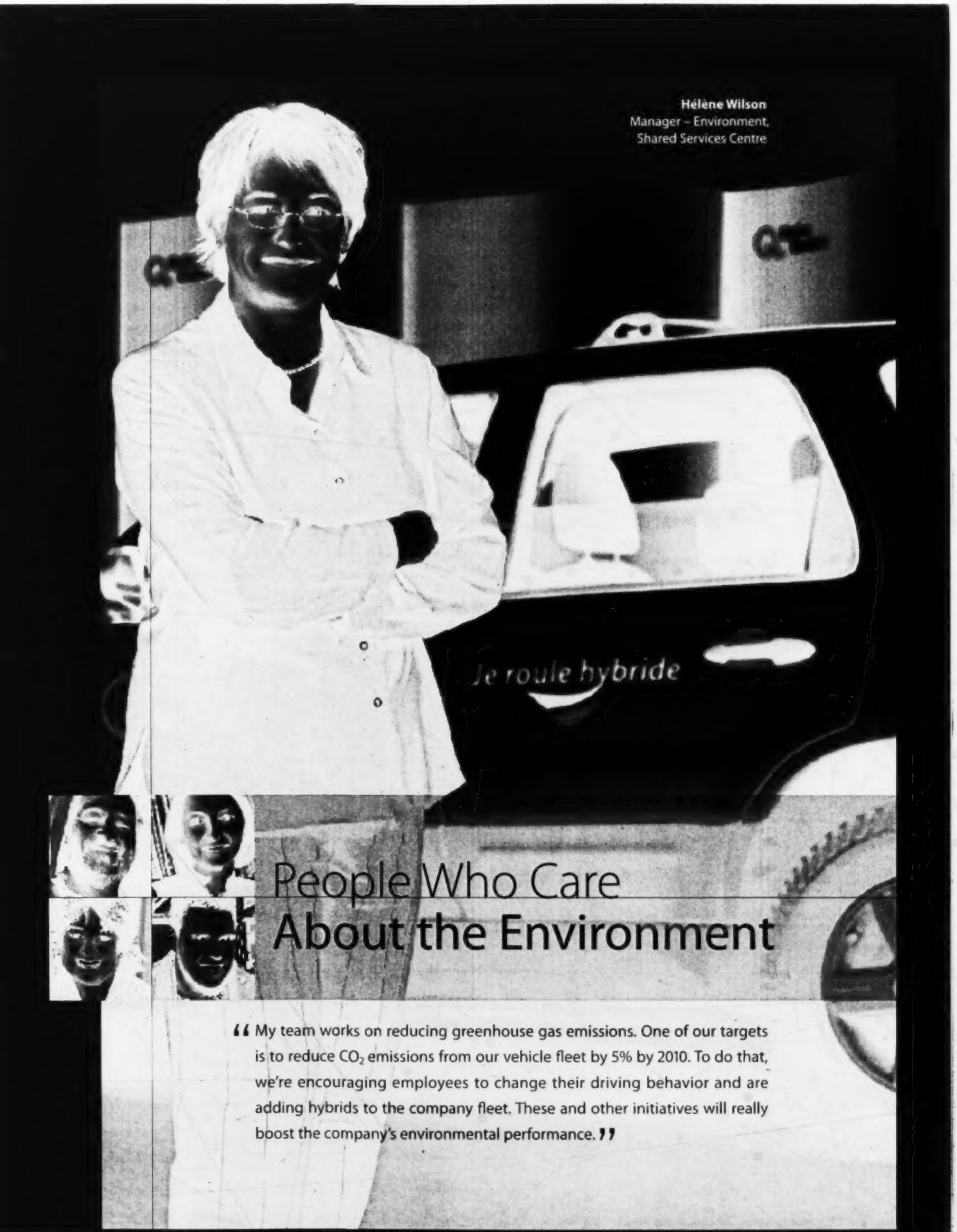
We began the design activities planned in the program for improving the performance of the present remote load-shedding system. This system, the only one of its kind in the world, enables us to maintain system stability in case of major problems such as the simultaneous loss of two or more lines. We also designed and installed load-shedding devices at 14 substations, in cooperation with the teams in charge of Hydro-Québec TransÉnergie's telecommunications and automatic controls.



Construction is moving briskly at the Péribonka site.



Mercier generating station, ready to come on stream in 2006.



Hélène Wilson
Manager – Environment,
Shared Services Centre

People Who Care About the Environment

"My team works on reducing greenhouse gas emissions. One of our targets is to reduce CO_2 emissions from our vehicle fleet by 5% by 2010. To do that, we're encouraging employees to change their driving behavior and are adding hybrids to the company fleet. These and other initiatives will really boost the company's environmental performance."

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Investing in the future

Since its creation in 1944, Hydro-Québec has depended on hydropower: 97% of the power it generates is from water. While maintaining our commitment to hydroelectric projects, we stepped up our efforts to promote the development of wind power and other renewable energy sources. We also raised the conservation target in our Energy Efficiency Plan by more than a third. And we are proud to report that as of 2005, all employees whose activities are likely to have an impact on the environment operate within the framework of environmental management systems certified under ISO 14001. We periodically measure our performance so that we can keep improving our ways of doing things.

OUR COMMITMENT

"Development that meets the needs of the present without compromising the ability of future generations to meet their own needs."

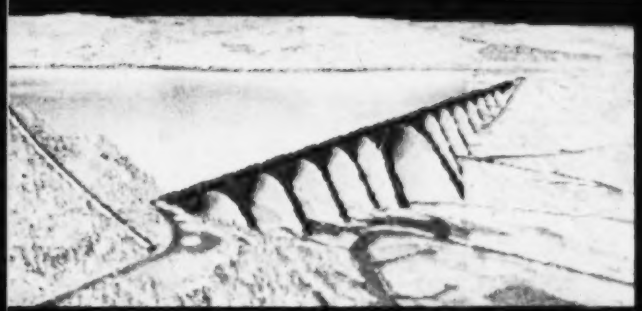
This is how the Brundtland Commission report defined the concept of sustainable development in 1987. The idea is to progress in terms of economic development, environmental protection and social development, all at the same time.

Hydro-Québec adheres to this objective. It underlies our values and our policies, and constitutes the foundation for our practices and our day-to-day management.

OUR OPERATIONS

In all our fields of endeavor, from planning and research to construction and operation, we work with a view to sustainable development. We encourage the responsible use of resources by our workforce and our customers. Every year, substantial funding is allocated to environmental conservation. We take the necessary steps to safeguard the health and safety of the public and our employees. We work with local groups to promote social and economic progress while collaborating with regional, national and international organizations on sustainable development issues.

We are preparing for the future while meeting the needs of the present.



Hydropower, our specialty, is a clean, renewable energy source.

Promoting renewable energy

To ensure that Quebecers have a secure energy supply, we rely mainly on water, a clean, renewable energy source that contributes to Québec's excellent performance with regard to greenhouse gas emissions.

In 2005, we made choices that reinforced our commitment to sustainable development. First, we favor developing water and wind as complementary power generation options in Québec. We are also interested in other renewables, such as biomass, geothermal and solar power, and in their use by customers wishing to generate their own electricity.

Preserving the environment

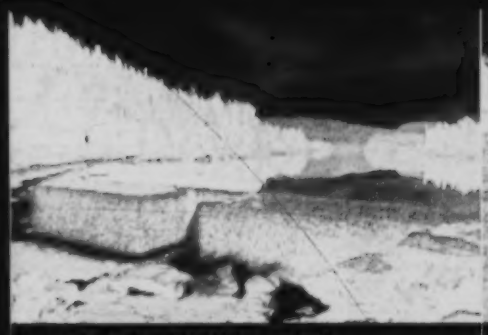
We are stepping up efforts to reduce the environmental impact of our operations. At the same time, our research enhances the body of knowledge about Québec's environmental resources and heritage.

Hydro-Québec is a leader in environmental protection.

- We adopted an action plan to reduce greenhouse gas (GHG) emissions from our vehicle fleet by 5% within five years. Among the avenues we want to explore are changing driving habits, purchasing more compact vehicles or vehicles with hybrid engines, testing electric vehicles on the Island of Montréal and having our line crews use batteries to power their tools.

- In 2005, we obtained ISO 14001 certification for the remaining units for which certification was planned. Environmental management systems that comply with this international standard now govern the actions of all employees whose work has an impact on the environment (over 20,000 people).

- The Fondation Hydro-Québec pour l'environnement granted over $1 million for 20 projects to protect, rehabilitate or enhance natural areas. These projects are located throughout Québec.



In order to conserve fish habitats, we build weirs that raise water levels.

When construction work is completed, jobsites are restored. More than 200,000 trees were planted at Toulnustouc.

- Under an initiative launched by Hydro-Québec to make the United Nations Climate Change Conference: Montréal 2005 a "Climate Positive" event, 26 organizations committed to offsetting twice the GHG emissions caused by the conference, or about 70 kilotonnes of CO_2. The plans include reforesting 101 hectares of woodlands and planting nearly 13,000 trees in urban and rural areas and around schools in 2006.

- As part of the Eastmain-1 hydroelectric project, we created 600 m^2 of spawning sites for walleye and brook trout.

- We are making steady progress in our efforts to recycle, recover and reuse raw materials. In 2005, we recycled over 653 tonnes of paper and paperboard, 10.3 tonnes of glass, plastic and metal containers and 8,740 tonnes of metal.

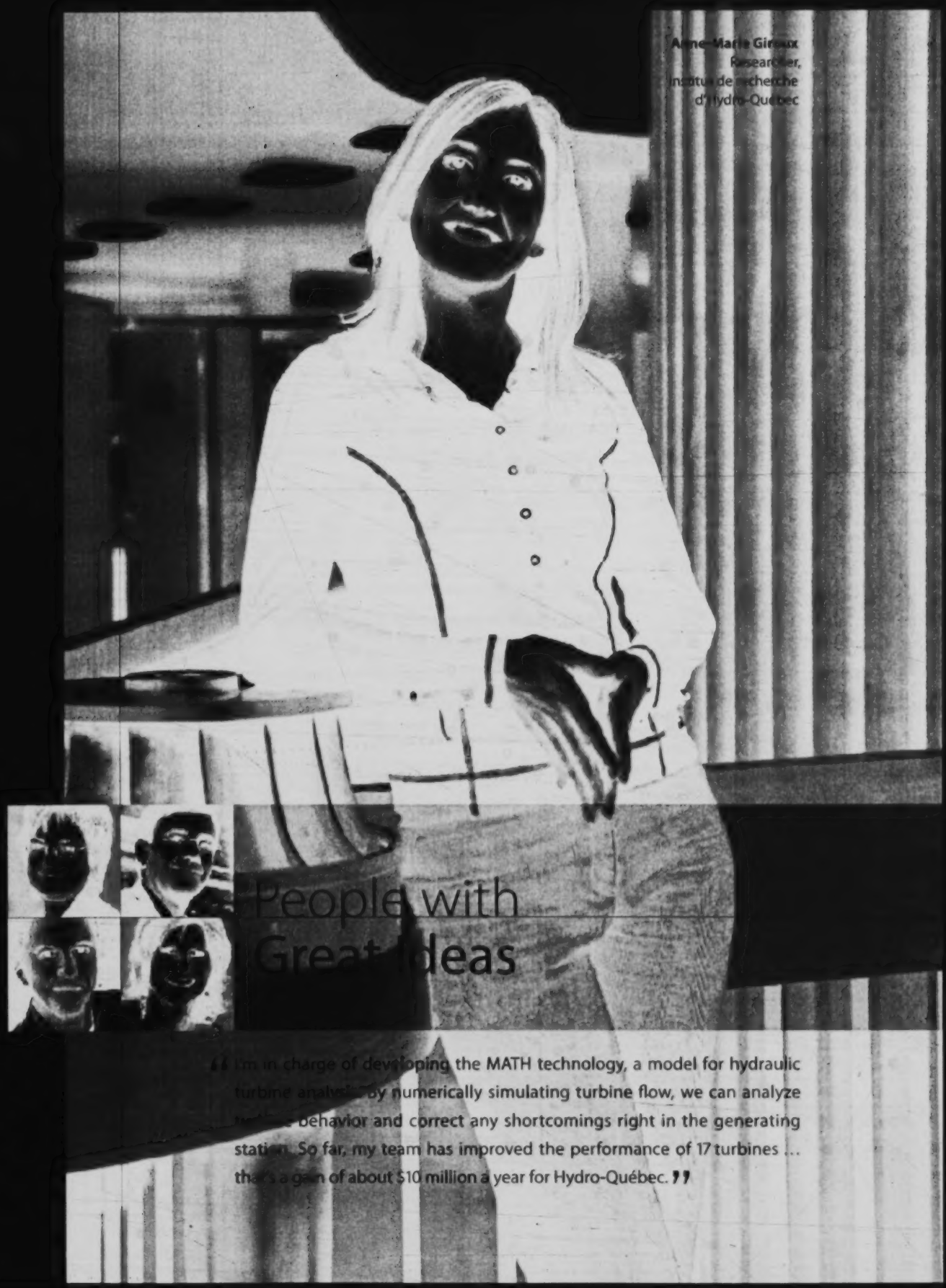
- The installation of a closed-loop cooling system in the laboratories at Hydro-Québec's research institute will reduce our annual consumption of drinking water by 56 million litres.

- The City of Montreal awarded us a Heritage Emeritus Award for our restoration of the Tolhurst pumping station in the Borough of Ahuntsic-Cartierville. The building's harmonious integration into its surroundings was judged to be exemplary. The pumping station, which was built in the 1920s at the same time as Rivière-des-Prairies generating station, belongs to Hydro-Québec.

- Archaeological digs conducted for the Eastmain-1 project unearthed traces of human occupation dating from 4,400 years ago. Tens of thousands of flakes have been collected, along with hundreds of tools and ceramic shards. Analysis of these items will contribute to our understanding of the occupation of the various sites.

Climate Positive

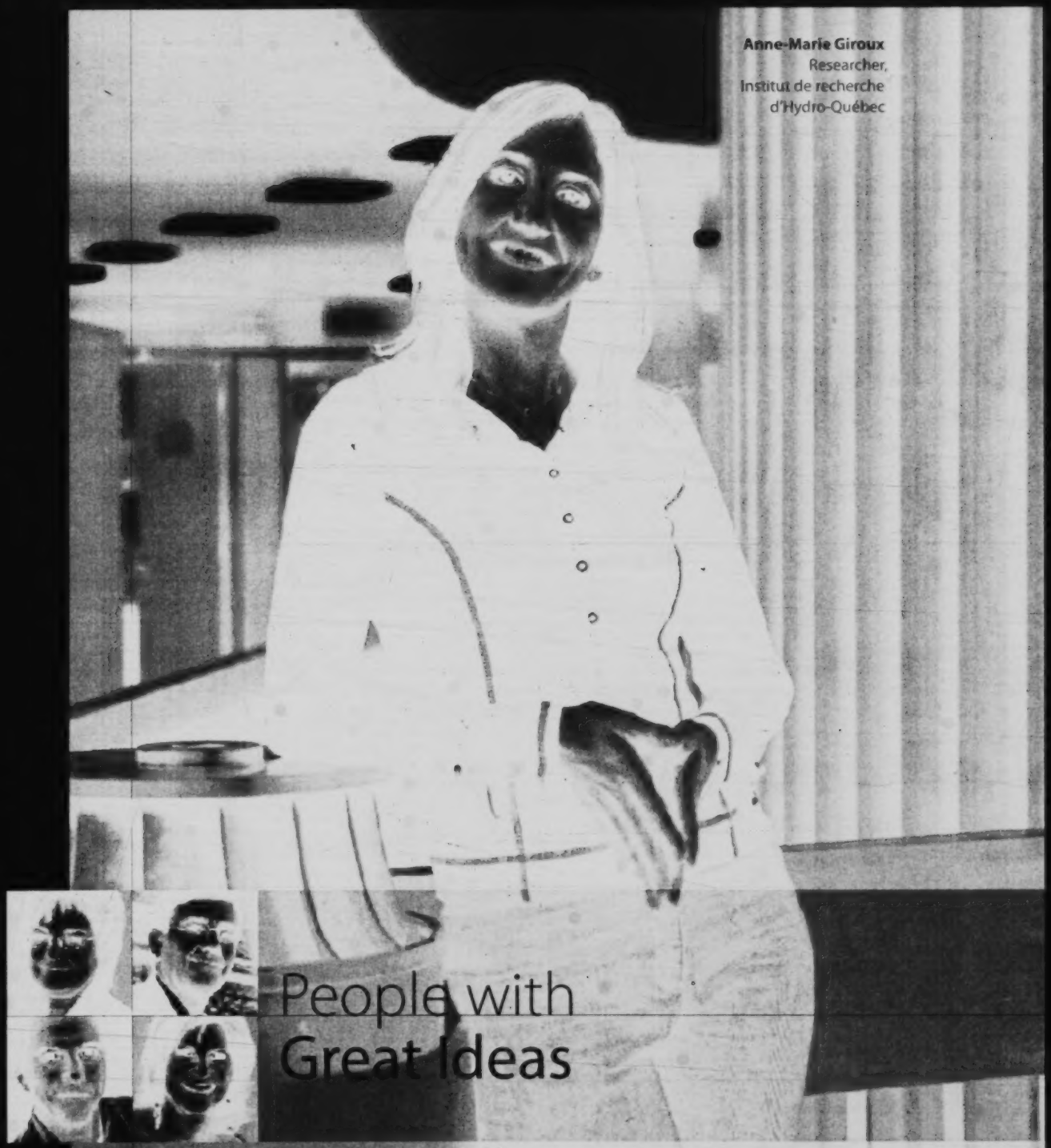
For the United Nations Climate Change Conference: Montréal 2005, we launched an initiative to offset GHG emissions.



Anne-Marie Giroux
Researcher,
Institut de recherche
d'Hydro-Québec

People with Great Ideas

"I'm in charge of developing the MATH technology, a model for hydraulic turbine analysis. By numerically simulating turbine flow, we can analyze [illegible] behavior and correct any shortcomings right in the generating station. So far, my team has improved the performance of 17 turbines ... that's a gain of about $10 million a year for Hydro-Québec."



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A leader in energy innovation

We are preparing for the future while meeting the needs of today. Our teams of researchers focus on encouraging wiser electricity consumption and optimizing our generating, transmission and distribution facilities in terms of performance and service life. In 2005, our research institute had a budget of $96 million.

We are capitalizing on our innovativeness and our extensive network of partners.

- We renewed our commitment to the Ouranos consortium for five years; Ouranos deals with regional climatology and adaptation to climate change. In cooperation with government agencies and universities, we are endeavoring to obtain as accurate a picture as possible of climate change in Québec in order to predict its impact on our operations.

- Hydro-Québec's energy technologies laboratory (LTE) in Shawinigan received the Énergia award from the Association québécoise pour la maîtrise de l'énergie for its electric thermal storage system, ThermElect. The LTE focuses exclusively on innovative technologies for energy efficiency.

- Hydro-Québec's research institute joined with the Natural Sciences and Engineering Research Council, a dozen Canadian universities and several public- and private-sector partners to create the Solar Buildings Research Network.

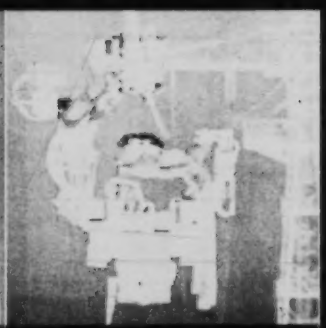
- To facilitate the integration of wind power, we developed prototypes designed to assess the impact of wind turbines on power system stability.

- In a project on real-time active system management and optimization (GAEL), we are exploring the possibility of enhancing power system reliability and flexibility while increasing transmission capacity. Various technologies and methods are being tested.

- Our subsidiary TM4 is helping to transform the automobile industry by marketing hybrid and electric drivetrains to major automakers. In 2005, the Dassault Group, a major French industrial concern, bought an 18.3% holding in TM4.

A probe developed by Hydro-Québec's research institute for the video-inspection robot used at Gentilly-2 nuclear station. It is equipped with a video camera for remote inspection of reactor components.

Ashok K. Vijh, Research Fellow at Hydro-Québec's research institute, is the President of the Academy of Sciences of the Royal Society of Canada.



LineScout, a robot used to inspect live transmission lines, developed by Hydro-Québec's research institute. It is able to get around obstacles such as insulator strings.

Cultivating pride and loyalty

We constantly strive to foster the commitment of the men and women who are responsible for our success. In addition, we have a corporate succession support plan to help us prepare for a wave of retirements in the coming years. We also maintain high occupational health and safety standards.

Achievement of our objectives depends on the skills and commitment of the women and men who work at Hydro-Québec.

- In an annual survey completed by 13,000 respondents in 2005, employee motivation and overall job satisfaction reached their highest levels ever.

- The collective agreement with the professionals' and scientists' union at our research institute was renewed in 2005. In addition, Hydro-Québec and the line workers' union reached an agreement on career planning and new staffing conditions.

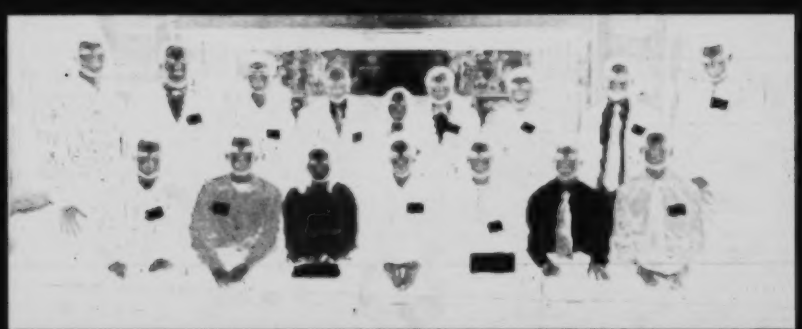
- For the first time, we accepted college-level interns for work-study programs in such disciplines as mechanical engineering, civil engineering and building mechanics. This pilot project produced good results and we made it a permanent program in January 2006. We also hired 178 university students, 14 of whom did internships in environmental sciences.

- In 2005, the work-related accident frequency was 3.26 per 200,000 hours worked, compared to 3.34 in 2004. Our occupational health and safety performance has improved steadily every year.

- Training is crucially important for the company. Our training budget in 2005 represented 3.9% of payroll, and 72.8% of our employees took part in at least one training activity.

- We adopted strategies, objectives and an action plan for managing diversity at Hydro-Québec. In 2005, recruitment of target groups increased, particularly Aboriginals and visible and ethnic minorities.

- Under the employee social involvement program, Hydro-Québec contributes up to $1,000 to associations in which our employees volunteer. In 2005, 237 employees took advantage of this program for a total of $186,500.



Winners of Hydro-Québec scholarships awarded to students of the Institute of Electrical Power Engineering.

Giving is part of our culture

A value that is deeply anchored in our history is support for organizations that contribute to the quality of community life. For this reason, Hydro-Québec gives donations and sponsorships to social, cultural, economic and environmental projects throughout the province. In 2005, it dedicated $24 million—1% of its net income—to such causes, including research contracts granted to various universities.

Culture

- A number of major cultural events in Québec received our support: the Festival international de Lanaudière, the Petite-Vallée song festival, the Québec City Summer Festival, the Festival des traditions du monde, International FestiBlues of Montréal, the Québec Carnival and the Fête des Neiges de Montréal.

- As a loyal sponsor of a number of theatre groups throughout the province, Hydro-Québec supported Théâtre À Cœur ouvert in LaSarre, Théâtre La Rubrique in Saguenay, Théâtre du Nouveau Monde in Montréal, Théâtre Les Clefs Magiques in Sainte-Agathe-des-Monts and Théâtre du Trident in Québec City, among others.

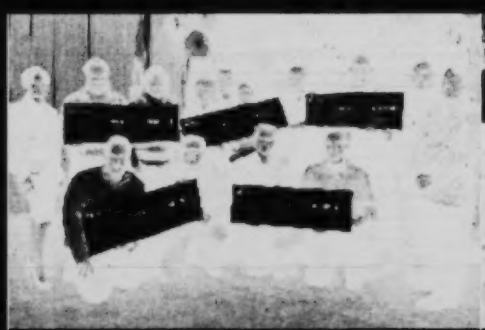
- Hydro-Québec provides funding to all the symphony orchestras in Québec, including those in Rimouski (l'Estuaire), Saguenay, Laval, Longueuil, Trois-Rivières, Québec City and Montréal. Other musical ensembles also receive support, such as the Orchestre Métropolitain du Grand Montréal, Ensemble Arion, Les Violons du Roy and Montréal's I Musici chamber orchestra.

- Hydro-Québec is involved with Québec's major museums, supporting various exhibitions as well as educational activities for children at museums in Sherbrooke and Québec City.

Health, social and humanitarian

- Hydro-Québec contributed $1.5 million to the fund-raising campaigns of some fifty hospitals throughout Québec, including the Complexe hospitalier de la Sagamie, the Fondation du Centre hospitalier régional de Rimouski, the Fondation du Centre hospitalier des Vallées-de-l'Outaouais and the Fondation du Centre universitaire de Québec.

- Donations were made to over 150 organizations that help the sick or other people in difficulty, such as an association for the hearing-impaired in the Mauricie region, a palliative care facility in Rouyn-Noranda, a women's shelter in Rouyn-Noranda, the Portage Foundation in Québec City and the On the Tip of the Toes Foundation in Saguenay.



Centraide/United Way: in 2005, donations by employees and pensioners amounted to more than $2.6 million and Hydro-Québec contributed an equivalent amount, bringing our total contribution to nearly $5.3 million.

The energy efficiency tents featuring Inspector 00Watt and Cécile Compact at the International FestiBlues of Montréal.

Education and youth

- We allocated $8.9 million to Québec universities to support many projects in line with their development priorities. Over $1.6 million went to fund the work of research chairs in such fields as power line icing or occupational health and safety. Scholarships were also granted to encourage academic excellence. In addition, we enlisted university expertise in various fields and signed contracts worth over $3.5 million, mainly for research.

- To develop entrepreneurship among young Quebecers, Hydro-Québec supports Junior Achievement of Québec, the Office franco-québécois pour la jeunesse and the Fondation du maire de Montréal pour la jeunesse. We also contributed to the Québec Entrepreneurship Contest in the Lower St. Lawrence region.

Socioeconomic

- We support various business groups that endeavor to create a favorable context for economic development in Québec.

- Our presence has a definite impact on the economy of each of the 17 administrative regions of Québec; our social and economic involvement is therefore a natural extension of our operations. Again this year, we supported chambers of commerce like those of Metropolitan Montréal, Québec City and Gatineau.

- The Canadian-Italian Business and Professional Association, the Association of Black Business Persons and Professionals, and the Fondation de l'entrepreneurship received our support.

Amateur sports

- To encourage youngsters and disabled people to participate in sports, Hydro-Québec supports the Défi sportif challenge for athletes with disabilities, the Special Olympics, and the summer and winter finals of the Québec Games.

- Other amateur sports events receive funding as well, including the Grand Prix Cycliste in the Beauce region, the Ivakkak Cup Race in Nunavik and the Eastern Arctic Games.

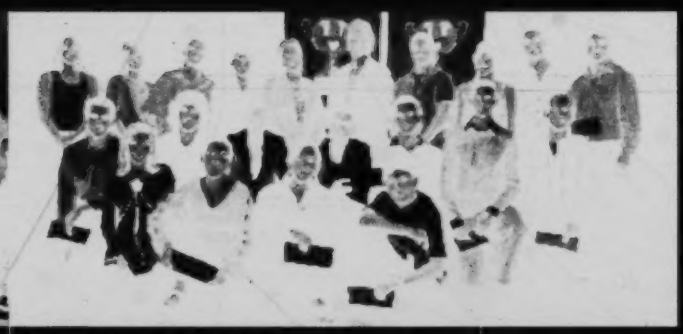
- Our contribution to the Québec Foundation for Athletic Excellence helps outstanding young amateur athletes across Québec.

Environment

- In addition to funding environmental projects through our Foundation, we supported such events as the sustainable development show in Montréal and an environmental project competition for grade-school students.

- To help organizations pursue their mission of public education, Hydro-Québec assisted the Société d'écologie des battures de Kamouraska, Pointe-aux-Outardes Nature Park, Rivière des Mille-Îles Park and Mitis River Park, to name only a few.

Fête des Neiges in Montréal.



Twenty-two young amateur athletes received $3,000 bursaries.

Working with communities and groups

Hydro-Québec is present throughout Québec. We endeavor to work closely with local authorities, agricultural interests and socioeconomic organizations, and to make sure our projects are accepted by the host communities.

We participate in the economic and social life of all the communities in which we operate.

- To contribute to regional socioeconomic progress, we signed 48 agreements with local communities in 2005. One of these provides for cooperation with two municipalities that operate a park on the site of La Gabelle hydropower development in the Mauricie region.

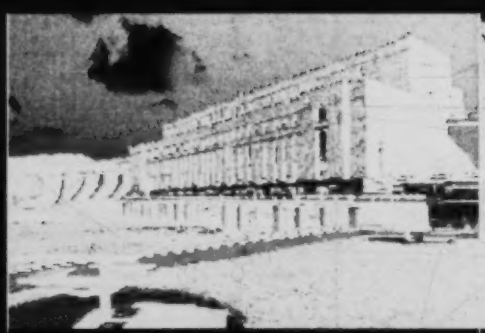
- Using the work done by our liaison committee with the UPA (farm producers' union), we prepared an energy efficiency proposal for agriculture. We developed experimental greenhouse projects and tested energy-efficient lightbulbs that provide the spectrum needed for photosynthesis.

- The work of the Hydro-Québec–UPA liaison committee also resulted in a frame of reference for wind farm development in agricultural and forest areas. This framework provides guidelines for farmers and wind power proponents concerning the siting of wind farms and mitigation of their impacts.

- Under our Integrated Enhancement Program, we funded 37 local initiatives for a total of $7.8 million in areas where we completed major transmission line projects.

- We gave nearly 80 hectares of land to the Régie intermunicipale du Parc régional des Chutes Monte-à-Peine-et-des-Dalles under a three-year partnering arrangement.

- We paid out $2.7 million to restore and decontaminate the site of an old thermal power plant on Fort George Island near Chisasibi.



A park was created on the site of La Gabelle generating station.

Improvement work under the Integrated Enhancement Program has made Maricourt pond, in the Eastern Townships, a place of beauty once again.

Active well beyond our borders

Our activities outside Québec take various forms. We share our world-renowned expertise with international energy associations and provide technical assistance to certain developing nations.

Our gestures of solidarity and international cooperation are a source of great pride.

- For many years, we have been involved in the work of international energy organizations. For example, we have representatives on the boards of the World Energy Council, the International Council on Large Electric Systems (CIGRE) and the International Hydropower Association. The IHA promotes hydroelectricity as a clean, effective way to combat climate change.

- In 2005, we participated in 10 international cooperation projects, including an exchange program between the Crees of Eeyou Istchee in Québec and the Ngobe of Panama; the topics were health, renewable energy and sustainable development.

- During the 18th Centre Jacques Cartier Discussions, we organized and presented a conference on sustainable development issues for cities and territories in conjunction with the EDF group (Electricité de France).

On the ground throughout Québec

Hydro-Québec makes a major contribution to all regions of Québec through our operations, investments, procurement of goods and services, and purchases of electricity from private producers, as well as through the activities of our technology subsidiaries.

- Procurement of goods and services within and outside Québec totaled $2,367 million, comparable to 2004 and broken down as follows: $1,007 million for the purchase of goods, $31 million for rentals, $958 million for specialized work and services, and $371 million for professional services.

- Over 92% of these goods and services ($2,186 million) were procured from Québec companies.

Grands Prix québécois de la qualité. The Shared Services Centre received an award in the public agency category. Alain Savard, Vice President, Shared Services Centre (right), receives the award from John Paul Macdonald, Senior Vice President, Public Affairs, Bombardier Aerospace.

An international cooperation project gave the Crees of Eeyou Istchee in Québec (right) a chance to discuss issues with the Ngobe from Panama (left).

- For 2005, the number of jobs supported in the province as a whole by our procurement activities was 18,154, including 12,654 direct jobs.

- To guarantee security of supply and competitive prices, we are continuing to diversify our sources, particularly for strategic goods.

- We renewed our partnering agreements with three suppliers of strategic goods in Québec. These agreements give us the status of preferred customer and guarantee better cooperation and highly qualified local support.

- Our investments in various hydroelectric projects generated some 6,600 construction jobs in 2005.

Hydro-Québec Procurement by Administrative Region[1] ($'000) in 2005

	Services[2]	Goods[3]	Total
Abitibi-Témiscamingue (08)	21,378	10,547	31,925
Bas-Saint-Laurent (01)	6,560	8,743	15,303
Capitale-Nationale (03)	177,342	49,414	226,756
Centre-du-Québec (17)	60,702	28,463	89,165[4]
Chaudière-Appalaches (12)	52,872	22,843	75,715
Côte-Nord (09)	53,683	16,880	70,563
Estrie (05)	7,153	5,910	13,063
Gaspésie–Îles-de-la-Madeleine (11)	3,364	2,274	5,638[5]
Lanaudière (14)	23,047	20,189	43,236
Laurentides (15)	44,109	31,795	75,904
Laval (13)	85,718	29,326	115,044
Mauricie (04)	108,667	20,469	129,136
Montérégie (16)	88,337	238,036	326,373
Montréal (06)	361,040	405,439	766,479
Nord-du-Québec (10)	10,422	2,281	12,703
Outaouais (07)	5,349	12,090	17,439
Saguenay–Lac-Saint-Jean (02)	149,487	21,814	171,301
Total	**1,259,230**	**926,513**	**2,185,743**

1. Amount billed by suppliers located in the administrative region.

2. Specialized services, professional services and other work.

3. Purchases and rentals.

4. This amount does not include spinoffs from the construction of the Bécancour cogeneration facility (TransCanada Energy).

5. This amount does not include spinoffs from wind power.

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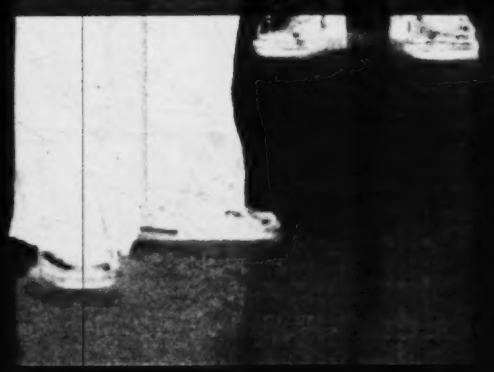

From the Finance Group

Nicole Lévesque
Advisor – Specialized Accounting

Michel Bélisle
Manager – Financial Statements

Lise Croteau
Corporate Controller

Marc-André Giguère
Advisor – Financial and Management Accounting

Nadine Poirier
Advisor – Control

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Management's Discussion and Analysis

Overview

Income from continuing operations went from $2.13 billion to $2.25 billion, for an increase of $124 million.

Operating income rose by $230 million (5.4%) to $4.5 billion. This improvement was mainly the result of increased short-term net electricity exports, whereas during the first half of 2004, the Corporation limited exports and increased electricity purchases in order to replenish its energy reserves. On the other hand, income was reduced by the higher pension expense and the increase in depreciation and amortization.

Net income totaled $2.25 billion, down $183 million from 2004, mainly because of the $265-million gain on the sale of our interest in Noverco in 2004, presented under discontinued operations.

Financial expenses were $2.2 billion, up $103 million (4.9%) from 2004, chiefly because of the foreign exchange gain recognized in 2004 following a revaluation of the natural hedge between debts and sales in U.S. dollars.

Revenue totaled $10.9 billion, or $491 million (4.7%) more than in 2004. This increase can be credited to good performance on external markets and greater revenue from electricity sales in Québec as a result of demand growth and rate adjustments. However, growth in Québec sales caused the 165-TWh heritage pool to be exceeded for the first time and obliged the Distributor to purchase electricity at market prices. The gross cost of this supply ($229 million) exceeded the additional revenue from sales in Québec ($199 million).

Assets and liabilities held for sale, presented in the balance sheet, reflect the Corporation's decision to sell off most of its foreign interests in order to focus its resources and efforts on its core businesses and the ambitious capital investment program supporting them.

Return on equity was 13.4%, as against 15.5% in 2004. This indicator is a sign of our healthy financial performance, considering that the sale of our interest in Noverco contributed to return on equity in 2004.

Cash from operations rose 12.7% to $4.4 billion. These funds enabled us to pay the dividends declared in 2004 ($1,350 million) and finance a large portion of our investments. Revenue from the sale of the assets of our subsidiary HydroSolution, Limited Partnership ($92 million) and funds repatriated to the parent company from a foreign subsidiary ($109 million) were added to cash from operations. The high volume of capital outlay, which totaled $3.3 billion in 2005 versus $3.1 billion in 2004, reflected the Corporation's continued activity in major projects in the Generation and Transmission segments.

Dividends declared were $1,126 million. This ninth consecutive annual payment will bring the total amount paid to our shareholder since 1998 to nearly $6.4 billion.

This Management's Discussion and Analysis should be read in conjunction with the Consolidated Financial Statements of Hydro-Québec and the notes thereto. The financial information and tabular amounts presented herein are expressed in Canadian dollars, unless otherwise indicated. The Consolidated Financial Statements take into account certain accounting practices that are specific to regulated enterprises. These practices are detailed in Note 3 to the Consolidated Financial Statements.

Hydro-Québec would like to point out that this analysis, and especially the Outlook section, contains statements based on estimates and assumptions concerning future results and the course of events. Given the risks and uncertainties inherent in any forward-looking statements, Hydro-Québec's actual future results could differ materially from those anticipated. It should also be noted that certain financial and operating data for previous years have been reclassified to respect the presentation adopted in 2005. Finally, the information contained herein takes into account any significant event that occurred on or before March 10, 2006.

Consolidated Results

Our analysis focuses on Hydro-Québec's consolidated results and financial position, as well as on integrated enterprise risk management. We then present the operating results, investing activities and risk management for each segment, followed by our outlook for 2006.

Operating results

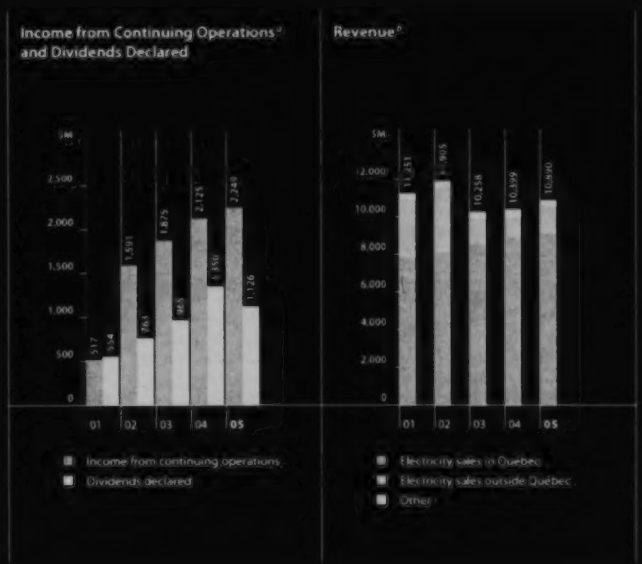
Income from continuing operations amounted to $2,249 million in 2005, versus $2,125 million in 2004, up $124 million (5.8%) due to the fact that the $230-million (5.4%) increase in operating income was partially offset by a $103-million (4.9%) increase in financial expenses. Net income totaled $2,252 million, down $183 million (7.5%) from the prior year. It should be noted that the 2004 net income included a $265-million gain on the sale of our interest in Noverco.

Revenue was $10,890 million in 2005, as against $10,399 million in 2004. This $491-million (4.7%) increase was due to increased electricity sales both inside ($199 million) and outside Québec ($380 million).

Sales in Québec totaled $9,121 million, for a 3.3-TWh increase in volume and additional revenue of $199 million. In 2005, the heritage pool (165 TWh) was exceeded for the first time ever. Growth in revenue from domestic sales was driven by increased baseload demand from industrial customers, largely as a result of the commissioning of Phase II of the Alouette aluminum smelter. Rate adjustments also had a $108-million impact on sales revenue.

Revenue from sales on external markets rose $380 million (35.1%) for a slightly higher volume (6.6%), and stood at $1,464 million. This increase was the result of favorable market conditions, including high summer temperatures on the Eastern Seaboard.

Total expenditure was $6,421 million, or $261 million (4.2%) more than in 2004. Operating expenses rose $78 million (3.5%) because of the increase in pension expense ($144 million). If this item had been excluded, operating expenses would have been lower than in 2004. Electricity and fuel purchases went from $1,465 million in 2004 to $1,485 million in 2005 (up 1.4%), partly because Hydro-Québec Distribution had to procure 2.9 TWh of additional supply on the open market at a gross extra cost of approximately $229 million when the total demand in Québec exceeded the heritage pool. However, short-term electricity purchases related to exports by Hydro-Québec Production fell by $141 million. Depreciation and amortization expense was higher because of the commissioning of new facilities, the effects of the sinking fund method and the write-off of the Grande-Baleine draft-design study ($115 million), among other factors. The increase was mitigated, however, because the depreciation period for certain assets ended during the year.



a) Figures for 2001 to 2004 have been restated following the retroactive application of the accounting standards for foreign currency translation (2001 only) and asset retirement obligations.

b) Figures for 2001 to 2004 have been reclassified to present financial results related to discontinued operations separately.

Financial expenses totaled $2,214 million, versus $2,111 million in 2004, for an increase of $103 million (4.9%). This change is due to the recognition of a large foreign exchange gain in 2004 ($218 million) compared with only $1 million in 2005. Of the gain recorded in 2004, $154 million resulted from a revaluation of the natural hedge between U.S.-dollar debts and sales following the application of a new accounting standard. On the other hand, our interest expense in 2005 was $107 million lower than in 2004.

Income from discontinued operations amounted to $3 million in 2005, as against $310 million in 2004. The sale of our interest in Noverco in June 2004 had generated a gain of $265 million, on top of the $38 million in operating results recorded by the subsidiary for the first half of the year. In 2005, the sale of the assets of our subsidiary HydroSolution, Limited Partnership, resulted in a $48-million gain. Furthermore, having decided to sell off some of our foreign interests, we presented the operating results of the businesses involved under discontinued operations. Their 2005 results reflect the impact of the repatriation of funds to the parent company from a foreign subsidiary and the recording of a write-down for one of the holdings for sale.

	2005	2004
OPERATIONS AND DIVIDENDS ($M)		
Revenue	**10,890**	10,399
Operating income	**4,469**	4,239
Income from continuing operations	**2,249**	2,125
Discontinued operations	**3**	310
Net income	**2,252**	2,435
Dividends declared	**1,126**	1,350
BALANCE SHEETS ($M)		
Total assets	**60,432**	58,118
Property, plant and equipment	**50,588**	51,425
Assets held for sale	**2,311**	–
Long-term debt, including current portion	**34,427**	34,517
Liabilities related to assets held for sale	**1,385**	–
Shareholder's equity	**17,376**	16,220
RATIOS		
Return on equity (%)	**13.4**	15.5
Average cost of debt (%)	**7.6**	6.8
Capitalization (%)	**34.2**	32.8
Self-financing (%)	**56.9**	75.3
Interest coverage	**1.95**	1.77

Financial Position

Operating activities

Operating activities generated $4,423 million in 2005, versus $3,923 million in 2004. These funds were used to pay the dividends declared in 2004 and finance a large part of our capital program.

Investing activities

In 2005, Hydro-Québec invested $3.3 billion in property, plant and equipment and intangible assets, compared to $3.1 billion in 2004. In 2005, $1.9 billion was invested in development and $1.4 billion in asset maintenance and improvement.

As planned, Hydro-Québec Production earmarked a large share of its capital program for development projects, including completion of Toulnustouc generating station, which was commissioned in summer 2005, ongoing construction at Mercier, Eastmain-1 and Péribonka, and the start of construction at Chute-Allard and Rapides-des-Cœurs. In addition, refurbishment work continued at Beauharnois, Outardes-3 and Outardes-4, as did the government approvals process for the Eastmain-1-A/Sarcelle/Rupert project and draft-design studies for the Romaine complex.

Hydro-Québec TransÉnergie invested $793 million to handle demand growth, improve the quality of its assets, bring the output from Toulnustouc and the future Eastmain-1 powerhouse onto the grid and ensure the long-term operability of its facilities. Hydro-Québec Distribution invested $645 million to meet increased residential demand, enhance service quality and reach the objectives of the Energy Efficiency Plan 2005–2010.

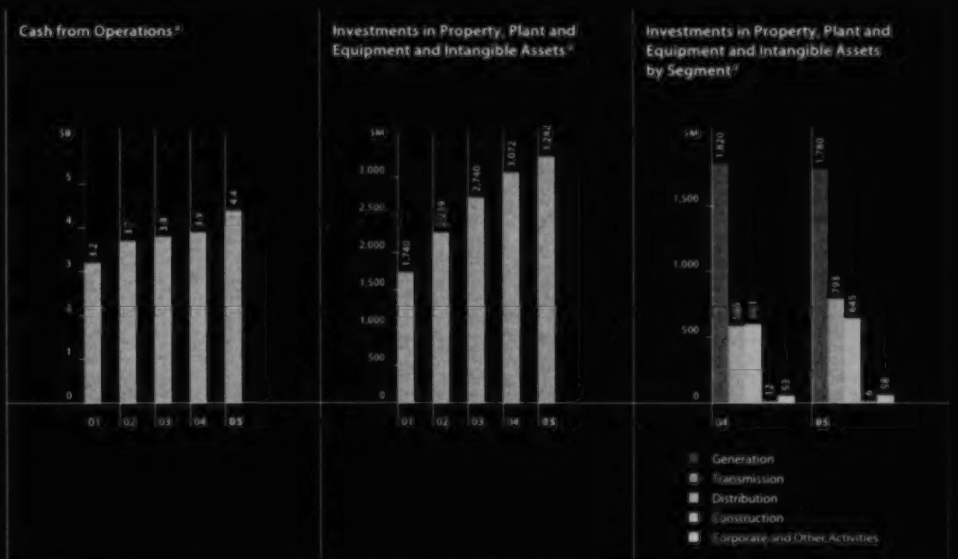
It should be mentioned that Hydro-Québec Équipement and Société d'énergie de la Baie James carry out most of the engineering and construction projects of Hydro-Québec Production and Hydro-Québec TransÉnergie.

Financing activities

Net issues of long-term debt in 2005 amounted to $507 million.

Hydro-Québec's gross borrowings, including receipts and disbursements related to credit risk management and other financings, amounted to $3,219 million in 2005, versus $1,549 million in 2004.

A bond issue maturing in February 2040 was launched on January 13 and reopened on May 25 and October 19. These operations raised $1,705 million at an average rate of 5.1%. In addition, three financings totaling $2,150 million were carried out through the issue of $1,500 million, $150 million and $500 million in variable-rate notes, maturing in 2009, 2006 and 2010, respectively. Issues of long-term debt reached $3,855 million and were all carried out on the Canadian market. The sale of the assets of our subsidiary HydroSolution, Limited Partnership, generated $92 million, and the repatriation of funds from a foreign subsidiary brought in $109 million, which reduced the corporate financing requirements for the year by corresponding amounts.



a) Figures for 2001 to 2004 have been restated in order to present cash flows from discontinued operations separately.

These funds enabled us to finance a portion of our capital program and redeem more than $750 million of debt before maturity. In addition, it should be noted that transactions carried out by Hydro-Québec to mitigate counterparty risk led to net cash outflows of $635 million.

Preauthorized Funding Sources

The Corporation has access to the following preauthorized funding sources:

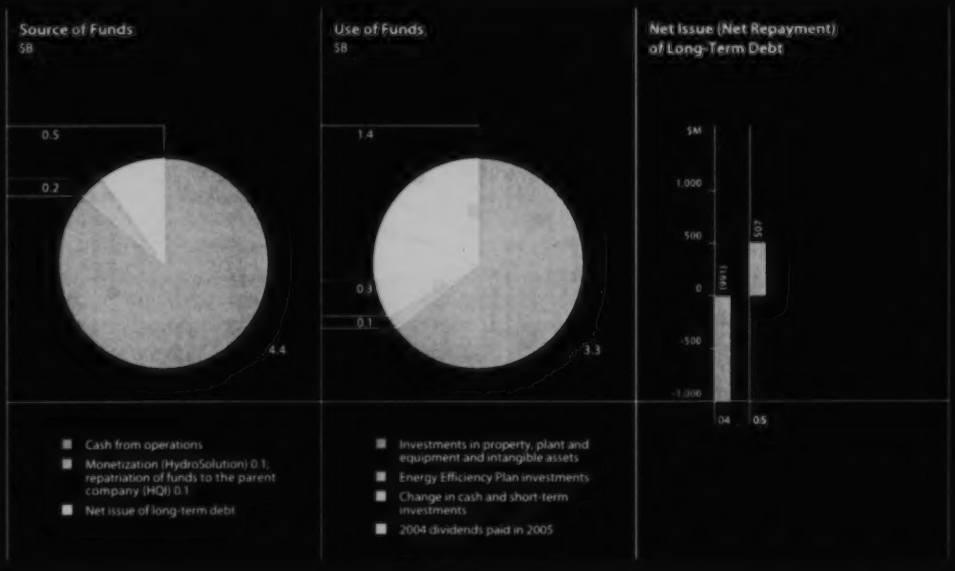
Type of financing	Authorized volume	Market	Outstanding as at December 31, 2005
Credit lines	US$350M or C$350M		–
	C$40M		–
	US$110M		–
Standby credit[a]	US$1,500M		–
Commercial paper[a]	US$2,250M or equivalent in C$	United States or Canada	C$20M
Medium-term notes[a]	US$3,000M or equivalent in other currency	United States	US$621M
	US$4,000M or equivalent in other currency	Euromarket	US$1,271M
	C$14,000M	Canada	C$11,411M

a) Guaranteed by the government of Québec.

Credit Ratings

Hydro-Québec's credit ratings are presented in the table below:

	2005	2004
U.S. agencies		
Moody's	**A1 positive**	A1 positive
Fitch Ratings	**AA– stable**	AA– stable
Standard & Poor's	**A+ stable**	A+ stable
Canadian agency		
DBRS	**A stable**	A positive



DIVIDENDS AND CAPITALIZATION RATE

Dividends of $1,126 million, or 50% of net income, were declared for 2005, since the Corporation had met all the necessary conditions with its year-end capitalization rate of 35.6%. When these dividends are factored in, our capitalization rate stands at 34.2%, compared to 32.8% in 2004.

The dividends declared in 2005 will constitute the ninth consecutive annual payment to our shareholder and bring the total amount paid since 1998 to nearly $6.4 billion.

Financial risks

The financial risks associated with the volatility of interest rates, exchange rates and aluminum prices are subject to active integrated management of market and credit risks. The objective is to limit the impact of adverse changes in these factors on the Corporation's results according to criteria determined each year on the basis of risk tolerance.

Energy trading risk

The wholesale trading operations of Hydro-Québec Production involve credit and market risks which are carefully monitored and rigorously managed. A team of specialists reporting to the Finance Group quantifies the credit and market risks and sees to it that the limits approved by Management and the Board of Directors are observed.

Integrated enterprise risk management

Hydro-Québec uses an integrated approach to risk management. Each division has set up a systematic, rigorous and recurrent process to determine, assess and manage the risks inherent in its activities. These risks are consolidated into a corporate portfolio overseen by the Management Committee, which acts as a risk management committee. The consolidated portfolio is presented to the Board of Directors during the development of the Strategic Plan and the annual Business Plan, and is reported on periodically.

Segmented Information

Hydro-Québec now has four operating segments, namely Generation, Transmission, Distribution and Construction, as well as activities grouped under the heading of Corporate and Other Activities. The main changes made to the organizational structure in 2005 are as follows:

- The subsidiary TransÉnergie HQ, which was part of the Transmission segment, was integrated into Corporate and Other Activities. This direct subsidiary holds our ownership interest in the Cross Sound Cable underwater link through its indirect subsidiary, Cross-Sound Cable Company, LLC. The assets and liabilities of this company, classified as held for sale since third quarter 2005, were sold under a contract signed in November 2005; the necessary approvals were obtained in February 2006 and the deal was closed on February 27, 2006.
- The operations of Hydro-Québec International, which had previously been distributed among the different segments according to the area of expertise of the foreign company concerned, were classified under Corporate and Other Activities in third quarter 2005.
- The operations of Hydro-Québec Pétrole et gaz, formerly a segment, are now part of Corporate and Other Activities.

In February 2006, the Board of Directors approved the creation of a Technology Group, comprising the following units: the Hydro-Québec research institute, technology commercialization and the controller's office of the Hydro-Québec Technologie et développement industriel division, transmission system telecommunications, telecommunications plans and standards, the corporate telecommunications network, telecommunications design, the subsidiaries Hydro-Québec CapiTech and Hydro-Québec IndusTech, and oil and gas exploration. Consequently, the Hydro-Québec Technologie et développement industriel and Hydro-Québec Pétrole et gaz divisions were abolished. Beginning in 2006, the group will be presented under Corporate and Other Activities.

Segment Highlights

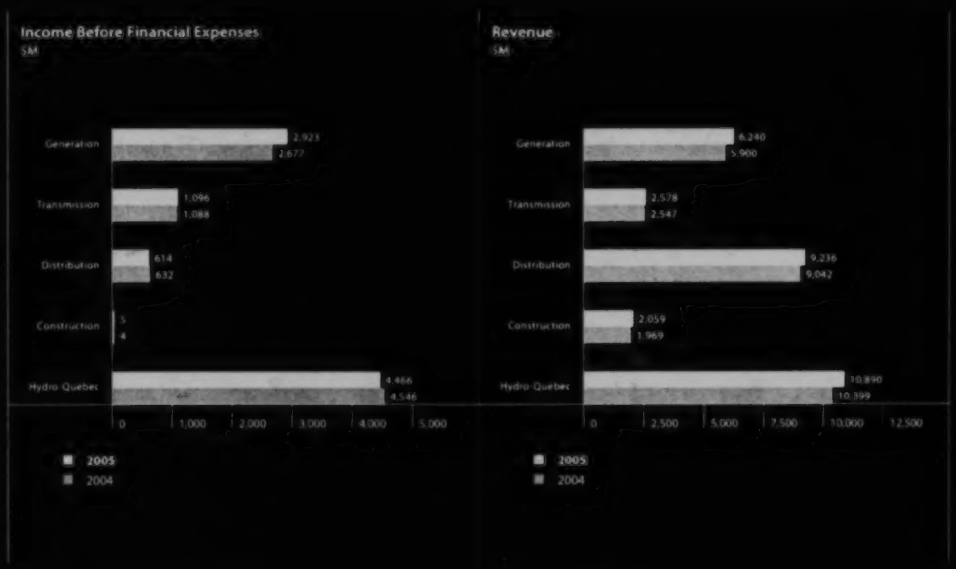
Since debt and financial expenses are managed for the Corporation as a whole and allocated among the various operating segments, income before financial expenses is presented below for each segment.

The **Generation** segment recorded income before financial expenses of $2,923 million, versus $2,677 million in 2004. This improvement resulted from growth in net reservoir drawdown, driven by favorable market conditions, which largely compensated for the increase in depreciation and amortization expense and pension expense.

The **Transmission** segment recorded income before financial expenses of $1,096 million, versus $1,088 million in 2004. The slight increase was mainly due to revenue growth from point-to-point transmission services and the reduction in depreciation and amortization; however, these two factors were partially offset by the increase in pension expense.

The **Distribution** segment recorded income before financial expenses of $614 million, compared to $632 million in 2004. This decline, which was mitigated by demand growth in Québec and by rate adjustments, was the result of the increased cost of external supply because the heritage pool was exceeded, and of the rise in depreciation and amortization expense and pension expense.

The **Construction** segment recorded a volume of activity of $2,059 million, compared to $1,969 million in 2004. As in the previous year, the increase stems from the upsurge in construction activities for Hydro-Québec Production and Hydro-Québec TransÉnergie, initiated in 2003.



Generation

Hydro-Québec Production has an obligation to provide Hydro-Québec Distribution with a maximum of 165 TWh of heritage pool electricity annually, at an average price of 2.79¢/kWh, according to conditions set out in the *Act respecting the Régie de l'énergie* as amended by the government of Québec in 2000. The division sells its excess output on deregulated markets in northeastern North America, including Québec, at market prices. It may also respond to the Distributor's calls for tenders in the context of free competition.

The division operates 59 generating stations. Its capital projects serve a twofold objective: to ensure the long-term operability of existing facilities and to continue development of Québec's hydroelectric potential.

Operating results

Hydro-Québec Production recorded net income of $1,873 million in 2005, an increase of $212 million (12.8%) over the previous year. This increase stemmed from favorable conditions for short-term electricity purchases and sales outside Québec, which translated into increased net reservoir drawdown for external markets. It should be remembered that in the first half of 2004, the division had stepped up its electricity purchases and limited its short-term sales outside Québec in order to replenish its energy reserves.

ELECTRICITY SALES TO HYDRO-QUÉBEC DISTRIBUTION

Electricity sales to Hydro-Québec Distribution totaled 165.1 TWh, versus 165.3 TWh in 2004. This slight decrease was owing to a drop in sales to the dual-energy market following the end of the related supply agreement, which was partially offset by an increase in heritage pool electricity. Revenue generated by sales to the Distributor amounted to $4,480 million, or $77 million less than in 2004. Electricity sales related to the Distributor's short-term calls for tenders were 0.2 TWh in 2005.

ELECTRICITY SALES OUTSIDE QUÉBEC

Electricity sales outside Québec generated revenue of $1,464 million for 15.3 TWh in 2005, compared to $1,084 million for 14.4 TWh in 2004. These sales correspond to energy marketing and trading on external markets. Short-term electricity sales went from $905 million (12.3 TWh) in 2004 to $1,290 million (13.3 TWh) in 2005, up $385 million, mainly because the division was able to increase its exports under favorable market conditions, while continuing to prudently manage its energy reserves. Long-term electricity sales were stable at 2 TWh. When short-term purchases are factored in, net exports and associated financial operations generated $830 million for a net reservoir drawdown of 6.7 TWh, compared with $384 million for 1.5 TWh in 2004.

ELECTRICITY AND FUEL PURCHASES

Electricity and fuel purchases amounted to $1,385 million in 2005, as against $1,507 million in 2004, down $122 million. Purchases for markets outside Québec totaled $609 million for 8 TWh, compared to $750 million for 12.2 TWh in 2004. The $141-million difference is due to the division's increased purchases in the first half of 2004 to replenish its energy reserves. However, transmission system reservation expenses were up $22 million, mainly because of higher sales volume outside Québec.

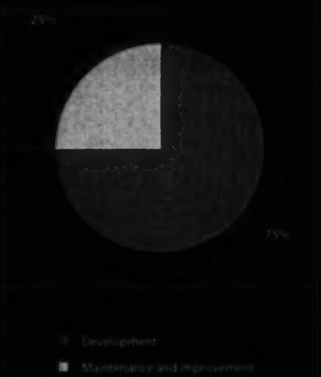
Hydro-Québec Production

Gestion Production HQ inc.	100%
HQ Energy Marketing inc.	100%
H.Q. Energy Services (U.S.) Inc.	100%
Bucksport Energy LLC	69.44%
Société en commandite Betsiamites	86.31%
Churchill Falls (Labrador) Corporation Limited	34.2%

Hydro-Québec division

Subsidiary, joint venture or interest held by Hydro-Québec and under the responsibility of Hydro-Québec Production

Breakdown of 2005 Investments by Hydro-Québec Production



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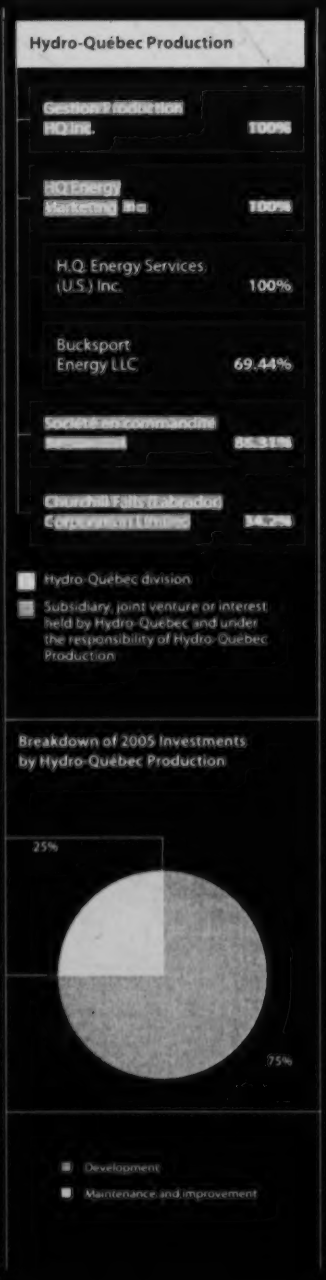


OPERATING EXPENSES

Operating expenses totaled $710 million in 2005, versus $663 million in 2004. The increase was chiefly due to a rise in pension expense of some $27 million and additional costs of $14 million to ensure security at facilities.

DEPRECIATION AND AMORTIZATION

Depreciation and amortization expense was $880 million in 2005, up $157 million from 2004, primarily as a result of the write-off of the Grande-Baleine draft-design study ($113 million). The commissioning of new plant and the effects of the sinking fund method also contributed to this increase.

Investing activities

In 2005, investments in property, plant and equipment and intangible assets affecting cash flow amounted to $1,780 million, of which $1,334 million was earmarked for developing Québec's hydroelectric potential in order to meet growth in demand. The main projects in this regard were the construction of Toulnustouc (commissioned in summer 2005), Mercier, Eastmain-1, Chute-Allard, Rapides-des-Cœurs and Péribonka generating stations, the environmental assessment of the Eastmain-1-A/Sarcelle/Rupert project and draft-design studies for the Romaine complex.

In addition, the division invested $446 million in refurbishing and improving its fleet. Most of the investments were for Beauharnois, La Tuque, Rapides-des-Quinze, Outardes-3 and Outardes-4 generating stations.

Risk management

Hydro-Québec Production manages its risk in an environment in which the principal uncertainty arises from weather conditions, and more specifically, natural runoff. The division must ensure that it is able to meet its commitments, namely to supply the heritage pool of electricity and fulfill its contractual obligations. In concrete terms, this means being able to cover a natural runoff deficit of 64 TWh over two consecutive years, and 98 TWh over four consecutive years. Hydro-Québec has made a commitment to demonstrate to the Régie three times a year that it is able to do so.

Its strategy is based primarily on multiyear management of energy reserves and on maintaining an adequate margin between its generating capacity and its commitments. This gives the division enough flexibility to compensate for runoff fluctuations, replenish its reserves or take advantage of business opportunities. The construction projects currently being studied or under way will give it a margin of about 15 TWh by 2010.

Transmission

Hydro-Québec TransÉnergie's power transmission service meets customers' growing needs in terms of quantity and quality at the lowest possible cost. The division ensures the reliability, long-term operability and optimal deployment of the power transmission system in Québec. Until February 2006, it was also responsible for the transmission system's telecommunications network.

The division's transmission operations in Québec fall under the exclusive jurisdiction of the Régie de l'énergie.

Hydro-Québec TransÉnergie

Cedars Rapids Transmission Company, Limited 100%

Hydro-Québec division

Subsidiary held by Hydro-Québec and under the responsibility of Hydro-Québec TransÉnergie

Operating results

Net income was $369 million in 2005, composed of net income of $378 million for regulated activities and a net loss of $9 million for unregulated activities, primarily telecommunications. The $40-million drop from $409 million in 2004 — chiefly attributable to regulated activities, which brought in $48 million less than in 2004 — is due to the fact that revenue growth was not sufficient to offset the increase in financial expenses and pension expense.

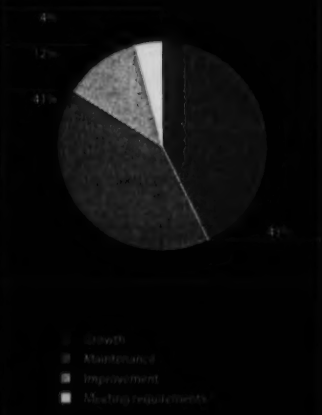
Revenue amounted to $2,578 million, up $31 million over 2004, mainly due to a $22-million increase in revenue from point-to-point transmission services.

Operating expenses were $671 million in 2005, as against $630 million in 2004, for an increase of $41 million. Two factors were involved: an increase in pension expense of some $27 million and additional costs of $11 million to ensure security at facilities.

Depreciation and amortization expense stood at $575 million, down $12 million from 2004.

Financial expenses totaled $727 million, or $48 million more than in 2004.

Breakdown of 2005 Investments by Hydro-Québec TransÉnergie



Investing activities

In 2005, Hydro-Québec TransÉnergie invested $793 million in property, plant and equipment and intangible assets affecting cash flow, as well as $18 million in other assets. Of these amounts, $740 million was allocated to regulated activities and $71 million to unregulated activities.

REGULATED ACTIVITIES

Close to 45% of the outlay went to transmission system development in order to meet demand growth in Québec. In 2005, the division more than doubled the amounts invested in transmission system development to increase system capacity and connect new facilities to the grid.

In this regard, the connection projects for Toulnustouc and Eastmain-1 generating stations amounted to some $129 million in 2005. The work to connect Toulnustouc generating station, which totaled $47 million in 2005, was completed in the summer. The project involved building a 315-kV single-circuit line approximately 55 km long between the new 526-MW generating station and Micoua substation, which needed to be modified as a result, as did Bergeronnes and Jacques-Cartier substations. Connecting Eastmain-1 powerhouse, a project launched in 2004, will bring an additional 480 MW onto the grid, as well as the eventual output from Eastmain-1-A and Sarcelle. The work, slated for completion in 2006, represented an outlay of $82 million in 2005.

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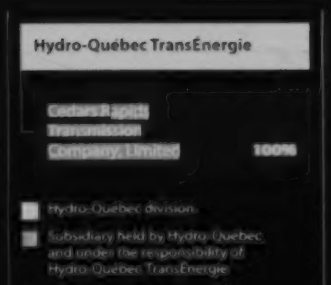
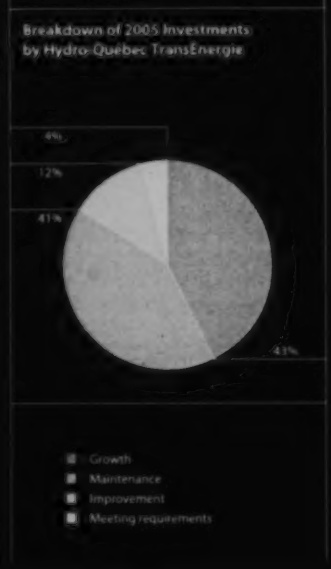

Hydro-Québec TransÉnergie
Cedars Rapids Transmission Company, Limited
100%
Hydro-Québec division
Subsidiary held by Hydro-Québec and under the responsibility of Hydro-Québec TransÉnergie



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In August 2005, the Régie approved a project to upgrade the Matapédia regional transmission system, which will enable Hydro-Québec TransÉnergie to bring power from future wind farms in the Gaspé region onto the grid without compromising the stability of the transmission system. The total cost of the project is estimated at $35 million, of which $16 million was committed in 2005. This project is part of the division's overall strategy for integrating the power resulting from Hydro-Québec Distribution's tender call for 990 MW of wind power.

In October 2005, Hydro-Québec TransÉnergie applied to the Régie for authorization to connect the future Péribonka generating station. This $185-million project, slated for completion in 2008, includes the construction of a switchyard, a switching station and a 135-km 161-kV line. Changes are also planned to the substations and lines already in place in order to loop part of the 161-kV system in the Saguenay region.

More than half the investments made in 2005 were designed to ensure the long-term operability of the system and maintain or improve asset quality. The division spent $258 million on replacing or refurbishing equipment, and $14 million on rebuilding and reinforcing the transmission system in the Port-Cartier region after the collapse of 14 towers during an ice storm on April 25, 2005.

An additional $29 million was invested in the ongoing project to secure the Québec City transmission system against extreme weather events. This $191-million project involves installing de-icing equipment to secure the power supply from three 735-kV source substations, namely Laurentides, Jacques-Cartier and Lévis. The equipment should be commissioned in summer 2007.

UNREGULATED ACTIVITIES

More than 90% of the $71 million invested in 2005 was earmarked for maintaining assets and responding to the growth in demand for transmission system telecommunication services.

Risk management

Hydro-Québec TransÉnergie practises integrated risk management in the course of its day-to-day operations.

The division has made continuity of transmission service its priority. It is therefore taking the necessary steps to successfully handle the winter peak and prevent major power failures. To do this, it has adopted a rigorous planning process and has deployed different means of securing its facilities and ensuring their long-term operability.

In the medium and long term, the division must connect new sources of supply (mainly wind farms and hydropower plants) to its system under optimal reliability and cost conditions. It has already improved the connection planning process and is currently reviewing the process for carrying out such projects.

The division conducts all its activities in accordance with the increasingly strict reliability standards set by the competent North American authorities.

Distribution

Hydro-Québec Distribution provides electricity to the Québec market and delivers reliable power to its customers as well as offering them services adapted to their needs.

The activities of Hydro-Québec Distribution are regulated by the Régie de l'énergie. In March 2005, the Régie approved an across-the-board rate adjustment of 1.2% that took effect on April 1, 2005. During the year, the Régie also ruled on new regulatory practices. Among other things, it authorized the division to record in a deferred expense account any unexpected change in the cost of supply beyond the heritage pool (165 TWh) as a result of volume or price variations. Also in 2005, Hydro-Québec Distribution filed its 2006–2007 rate application. In light of the increased cost of supply due to growth in demand, the Régie authorized an average rate adjustment of 5.3%, effective April 1, 2006.

Supplying the Québec market

Hydro-Québec Distribution relies on various sources in order to supply the Québec market. When demand exceeds the heritage pool (165 TWh) reserved by Hydro-Québec Production, the division issues short- and long-term calls for tenders to meet its needs. For requirements of less than three months, it may also buy electricity directly on the market, without a call for tenders, under an exemption granted by the Régie. In addition, under the terms of a framework agreement signed with Hydro-Québec Production and approved by the Régie on November 8, 2005, the Distributor may purchase electricity from the Generator using the price formula established in the agreement to cover unexpected needs that it could not otherwise meet.

Electricity Supply Plan

Every three years, Hydro-Québec Distribution must file an electricity supply plan with the Régie outlining its strategy for meeting the needs of the Québec market. This plan takes into account the energy savings achieved through the Energy Efficiency Plan. In this regard, it should be mentioned that the division is continuing to put considerable effort into energy efficiency. Given the imperatives of sustainable development and in a context of steady demand growth, conservation has been identified as a key tool for cost-effective demand-side management. In fall 2005, Hydro-Québec Distribution raised the target in its Energy Efficiency Plan 2005–2010 from 3 TWh to 4.1 TWh.

On October 5, 2005, the Régie approved the Electricity Supply Plan 2005–2014 filed on November 1, 2004. The strategy proposed by the division consists in ensuring the necessary flexibility to meet demand at the lowest cost. On October 19, 2005, the division filed a report on the progress made toward achieving the objectives in the Plan.

Hydro-Québec Distribution

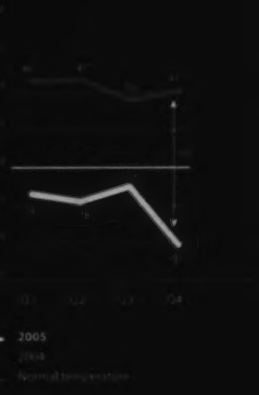
Hydro-Québec VariTech inc.	100%
Centre d'innovation sur le transport d'énergie du Québec (CITEQ) inc.	50%

Hydro-Québec division

Subsidiary, joint venture or interest held by Hydro-Québec and under the responsibility of Hydro-Québec Distribution

2005–2004 Change in Electricity Sales by Category

Cumulative Effect of Temperature in Comparison to the Norm



2005

2004

Normal temperature

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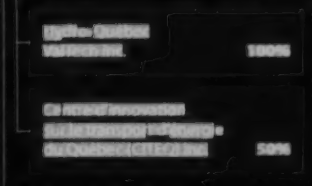
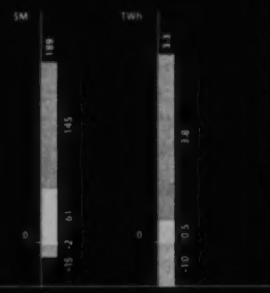


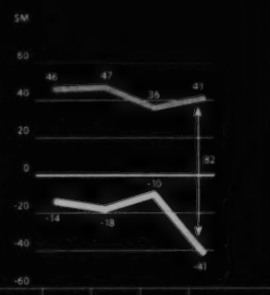
- Hydro-Québec division
- Subsidiary, joint venture or interest held by Hydro-Québec and under the responsibility of Hydro-Québec Distribution

2005–2004 Change in Electricity Sales by Category



- Industrial
- Residential and farm
- General and institutional
- Other

Cumulative Effect of Temperature in Comparison to the Norm



- 2005
- 2004
- Normal temperature

Calls for tenders

In 2004, Hydro-Québec Distribution launched its first calls for tenders on short-term markets, covering most of its supply needs for 2005. In 2005, it launched three calls for tenders to meet the year's other supply needs as well as a large portion of those anticipated for 2006. In February 2005, the division signed eight 20-year contracts for the purchase of wind energy. At the end of a call for tenders launched in 2004 for the purchase of electricity produced by cogeneration, it signed a 15-year contract in October 2005 pending approval from the Régie. Also in October, the division launched a tender call for the long-term purchase of 2,000 MW of wind energy produced in Québec, with staggered deliveries scheduled to begin in the period from December 1, 2009, to December 1, 2013. The deadline for bid submission is April 2007.

Operating results

Net income was $230 million in 2005, down $57 million from 2004. The increase in revenue from electricity sales as a result of growth in demand and rate adjustments, among other things, did not offset the increase in cost of supply, pension expense, depreciation and amortization expense, and financial expenses. The division realized a $48-million gain on the sale of the assets of HydroSolution, Limited Partnership.

REGULATED ACTIVITIES

Electricity Sales in Québec by Category

	Sales Volume			Sales Revenue		
	2005	2005–2004 Change		2005	2005–2004 Change	
Customer Category	TWh	TWh	%	$M	$M	%
Residential and farm	**57.0**	(1.0)	(1.7)	**3,675**	(15)	(0.4)
General and institutional	**33.7**	0.5	1.5	**2,295**	61	2.7
Industrial	**73.5**	3.8	5.5	**2,896**	145	5.3
Other	**5.0**	–	–	**245**	(2)	(0.8)
Total	**169.2**	3.3	2.0	**9,111**	189	2.1

Total sales revenue rose by $189 million (3.3 TWh) in 2005. Two factors account for the increase: growth in demand, especially in the industrial category, and rate adjustments.

Factors in the 2005–2004 Change in Sales by Customer Category

	Volume Effects								Price Effects		
	Baseload Demand		Temperature		Leap Year		Total		Rate Adjustments	Other	Total
Customer Category	TWh	$M	TWh	$M	TWh	$M	TWh	$M	$M	$M	$M
Residential and farm	0.5	36	(1.3)	(86)	(0.2)	(12)	**(1.0)**	**(62)**	47	–	**47**
General and institutional	0.5	35	0.1	6	(0.1)	(6)	**0.5**	**35**	29	(3)	**26**
Industrial	4.0	140	–	–	(0.2)	(7)	**3.8**	**133**	29	(17)	**(12)**
Other	–	3	–	(2)	–	(1)	–	–	3	(5)	**(2)**
Total	5.0	214	(1.2)	(82)	(0.5)	(26)	**3.3**	**106**	108	(25)	**83**

Significant growth in baseload demand in 2005 led to a 5.0-TWh increase in sales, for additional revenue of $214 million. The industrial category was the main driving force behind the increase, with additional consumption of 4.0 TWh ($140 million), chiefly because of the commissioning of Phase II of the Alouette aluminum smelter. Residential construction contributed to a 0.5-TWh ($36-million) increase in sales in the residential and farm category. Sales in the general and institutional category also rose 0.5 TWh ($35 million), in spite of the loss or migration of many customers in anticipation of the abolition of Rate BT on April 1, 2006.

The milder temperatures recorded in 2005, particularly in the first and fourth quarters, translated into a 1.2-TWh ($82-million) reduction in sales volume, mainly in the residential and farm category, which is more sensitive to temperature changes because of its heating requirements. Also, 2005 had one less day of consumption than 2004, a leap year, causing a year-over-year decrease of 0.5 TWh ($26 million).

Electricity and fuel purchases grew $181 million over 2004. For the first time, demand exceeded the heritage pool, forcing the Distributor to buy electricity on short-term markets at an average price of 7.8¢ per kilowatthour delivered, which explains the increase in the total cost of supply compared to 2004.

Operating expenses were $1,007 million in 2005, versus $971 million in 2004. The increase was due to the roughly $47-million rise in pension expense. If this item had been excluded, operating expenses would have been down $11 million from the previous year. The efforts deployed to contain distribution and customer service costs were instrumental in enabling the division to limit the increase in operating expenses in spite of a steady level of operation in a context of strong growth in domestic demand.

Depreciation and amortization expense totaled $489 million, or $42 million more than in 2004. This increase can largely be traced to the commissioning of several distribution assets in 2004. Amortization of the Energy Efficiency Plan, under which many programs were implemented in 2004, and the downward revision in the useful lives of certain assets also contributed to the increase.

UNREGULATED ACTIVITIES

Hydro-Québec Distribution's unregulated activities are the responsibility of Hydro-Québec ValTech. Income from these activities amounted to $52 million in 2005, up $49 million over 2004, due to a $48-million gain on the July 2005 sale of the assets of HydroSolution, Limited Partnership, a subsidiary of Hydro-Québec ValTech. HydroSolution specializes in the sale, leasing and installation of water heaters, and the sale and installation of home heating systems and air conditioners.

Investing activities

Under the category of investments affecting cash flow, Hydro-Québec Distribution invested $645 million in property, plant and equipment and intangible assets in 2005. All these investments concerned regulated activities, and more than one third went toward responding to growth in demand, including $183 million to hook up new customers. The division also invested $203 million to ensure long-term system operability and $133 million to improve the quality of service, including $87 million on the CIS (Customer Information System) project and $14 million on the program for distribution system automation. In addition, the division invested $46 million to handle third-party requests, honor contractual agreements and comply with standards or legal obligations concerning safety and the environment.

Hydro-Québec Distribution also invested $92 million in the Energy Efficiency Plan 2005–2010, which includes a variety of conservation programs for Hydro-Québec's different customer categories and aims at savings of 4.1 TWh by 2010. Achieving this objective will reduce Hydro-Québec's cost of supply.

Finally, as authorized by the Régie, the Distributor recognized $61 million in 2005 as deferred expenses relative to the abolition of Rate BT on April 1, 2006. This amount includes the deficit caused by the difference between revenue from electricity sold at this rate and the cost of supply recognized by the Régie, as well as expenses related to the financial incentives and advisory services offered to Rate BT customers.

Risk management

Hydro-Québec Distribution manages risk in the context of its day-to-day activities, relying on a range of measures to reduce its impact on operations and profitability.

The division operates in an environment in which electricity supply costs, capital spending and pension expense are all rising significantly. That is why it pays particular attention to risks that could affect its profitability, especially those related to supply, to the Energy Efficiency Plan and to recognition of all its costs by the Régie.

Hydro-Québec Distribution has taken various measures to reduce the impact of new supply on its cost of service. These measures include conditions in calls for tenders that allow quantities to be changed up to the time the contracts are awarded, and the negotiation of guarantees to protect against suppliers' failure to deliver. In addition, the Distributor obtained the Régie's approval to create an account for deferred expenses arising from any unexpected change in the cost of new supply. It also asked the Régie to approve the creation of a smoothing account for transmission and distribution revenue in order to neutralize the impact of any change in sales volume due to weather conditions.

Risk management for the Energy Efficiency Plan relies on a series of measures that include creating a control environment, seeking new energy efficiency solutions, developing new program conditions and simplifying procedures. All these measures are aimed at a single goal: achieving the energy savings target. These savings, it should be remembered, will limit recourse to costly sources of supply which would increase the Distributor's cost of service.

Construction

Hydro-Québec Équipement carries out engineering and construction for hydroelectric development projects throughout Québec, except in the territory governed by the *James Bay and Northern Québec Agreement*, where such work is handled by Société d'énergie de la Baie James (SEBJ). The division also builds power transmission lines and substations throughout the province.

As engineering and environmental specialists, Hydro-Québec Équipement and SEBJ also offer the generation and transmission divisions a variety of services needed for draft-design projects, impact assessments and other energy-related projects. These services include technical and scientific reports, planning, cost estimates, design, architecture, surveying and quality control.

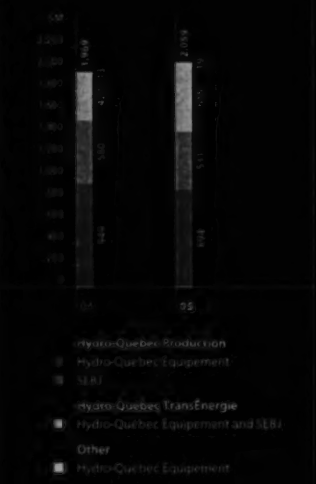
Hydro-Québec Équipement

Société d'énergie de la Baie James — 100%

Hydro-Québec division

Subsidiary held by Hydro-Québec and under the responsibility of Hydro-Québec Équipement

Breakdown of Construction Segment Activities



Volume of activity

In 2005, Hydro-Québec Équipement and SEBJ carried out activities worth a total of $2,059 million in 2005, compared to $1,969 million in 2004, a nearly 5% increase that reflects continued capital spending by Hydro-Québec. Work done for Hydro-Québec Production totaled $1,425 million, versus $1,529 million in 2004, while work done for Hydro-Québec TransÉnergie amounted to $615 million, versus $427 million in 2004.

HYDRO-QUÉBEC ÉQUIPEMENT

In 2005, Hydro-Québec Équipement carried out activities worth a total of $1,527 million, up $141 million (10%) from 2004. This sharp increase reflects continuing work on or completion of many projects in the Generation and Transmission segments, including completion of Toulnustouc generating station, commissioned in summer 2005; construction of Mercier and Péribonka generating stations; power plant refurbishment at Beauharnois, Outardes-3, Outardes-4, Grand-Mère, Rapide-2 and Rapide-7; and the connection of Toulnustouc, Eastmain-1 and Mercier generating stations to the grid. The division also continued work on projects to increase transmission system capacity. Work related to increasing the security of facilities began in 2005 and will continue in 2006.

SOCIÉTÉ D'ÉNERGIE DE LA BAIE JAMES

SEBJ's activities — mainly on behalf of Hydro-Québec Production — represented a total of $532 million in 2005, compared to $583 million in 2004, basically connected with continuing the Eastmain-1 project. Close to 80% of the work was completed: reservoir impoundment began in November 2005 and the project is scheduled to be commissioned in 2006. The notice of compliance of the Environmental Impact Statement for the Eastmain-1-A/Sarcelle/Rupert project was received in January 2006 and the approvals are expected in the course of the year.

Risk management

Increased activity by Hydro-Québec Équipement and SEBJ has a significant impact on the construction industry. Given the strong demand for construction services in Québec, there is upward pressure on project costs. Moreover, the future volume of activity of Hydro-Québec's Construction segment depends on several major projects that are subject to environmental authorization. In the short term, obtaining approvals for the Eastmain-1-A/Sarcelle/Rupert project is an essential condition for maintaining SEBJ's level of activity.

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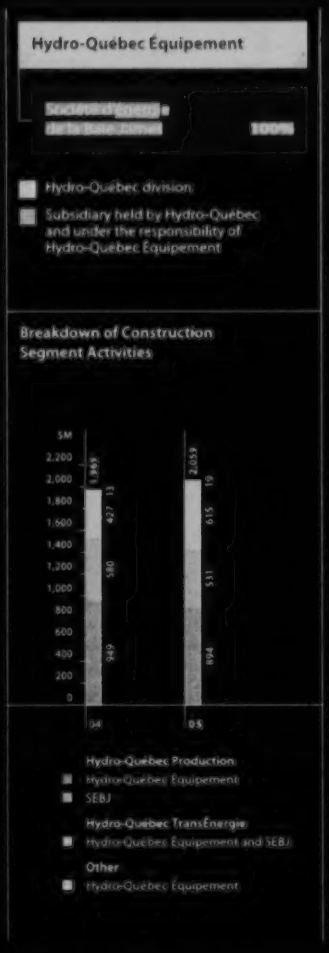

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Corporate and Other Activities

For 2005, this heading includes corporate activities, shared services, the subsidiaries Hydro-Québec International and TransÉnergie HQ, as well as the operations of the divisions Hydro-Québec Technologie et développement industriel and Hydro-Québec Pétrole et gaz, which come under the newly created Technology Group as of February 2006.

Results

Corporate and Other Activities generated a net loss of $217 million in 2005, versus net income of $127 million in 2004. This decrease was due to the sale of our interest in Noverco in 2004, which generated a gain of $265 million, on top of the $38 million of operating income recorded by Noverco in the first half of the year.

CORPORATE ACTIVITIES

Corporate activities include financial services, human resources, corporate affairs, and coordination of strategic planning and cases to be submitted to the Régie de l'énergie.

The Finance Group manages debt, financial expenses and financial risks (such as interest rate and foreign exchange risks) for the entire Corporation and then allocates the financial expenses to the operating segments. In addition, the Group oversees risk management activities by the divisions and corporate units, while also providing tax and accounting expertise for all business segments. It is also responsible for producing and analyzing the consolidated financial statements, including segmented information, and for managing the pension plan, whose assets amount to just over $11 billion.

SHARED SERVICES CENTRE

The Shared Services Centre helps the Corporation carry out its mission and reach its objectives by providing divisions and corporate units with a broad spectrum of support services: procurement of goods and services, material management, real estate management, transportation services, accounting services, document management, office automation systems, and information systems and technologies. Until February 2006, it was also in charge of corporate telecommunications. Its mandate is to provide its customers with quality services tailored to their needs at the lowest possible cost so that they can concentrate on their core operations.

The Shared Services Centre's income totaled $736 million in 2005, versus $732 million in 2004. Excluding pension expense, the Centre was able to reduce the cost of its products and services by 3.5% in 2005 through a series of optimization measures, in spite of inflation and a slight increase in customer demand.

HYDRO-QUÉBEC INTERNATIONAL

The year was marked by organizational changes and the implementation of a plan to sell off a number of foreign interests. This new departure reflects Hydro-Québec's desire to focus its resources and efforts on its core activities in Québec and on the substantial capital investment program needed to support them.

Hydro-Québec International's continuing operations generated a $19-million net loss in 2005, against a net loss of $24 million in 2004. The 2005 result is mainly due to cost overruns on technical service projects.

Discontinued operations generated a net loss of $53 million in 2005, versus a net loss of $3 million in 2004. The 2005 loss is mainly attributable to the creation of an allowance to account for the impairment of an interest held for sale, and to the impact of repatriating the funds held in a foreign interest to the parent company.

The Corporation recovered more than $124 million in 2005 in the form of dividends and a capital redemption, including $109 million from Chile, $8 million from Peru, $4 million from Panama and $3 million from Australia.

TRANSENERGIE HQ

TransÉnergie HQ inc., a wholly owned subsidiary of Hydro-Québec, has an interest in a submarine link, the Cross Sound Cable, through its indirect subsidiary Cross-Sound Cable Company, LLC. The assets and liabilities of this company, classified as held for sale since the third quarter of 2005, were sold under a contract signed in November 2005; the necessary approvals were obtained in February 2006 and the deal was closed on February 27, 2006.

TransÉnergie HQ recorded a $0.3-million net loss in 2005, compared to a $10-million net loss in 2004. The difference stems from the 2004 write-off of capital assets and development expenses for projects in the U.S.

Hydro-Québec International

HQI Transelec Chile S.A.
Chile **100%***

Hidroeléctrica Río Lajas S.A.
Costa Rica **50%**

Consorcio TransMantaro S.A.
Peru **56.66%**

MurrayLink Transmission General Partnership
Australia **50.5%**

DirectLink (JJV)
Australia **33.33%**

Empresa de Generacion Electrica Fortuna S.A.
Panama **16.3%**

Hydro-Québec subsidiary

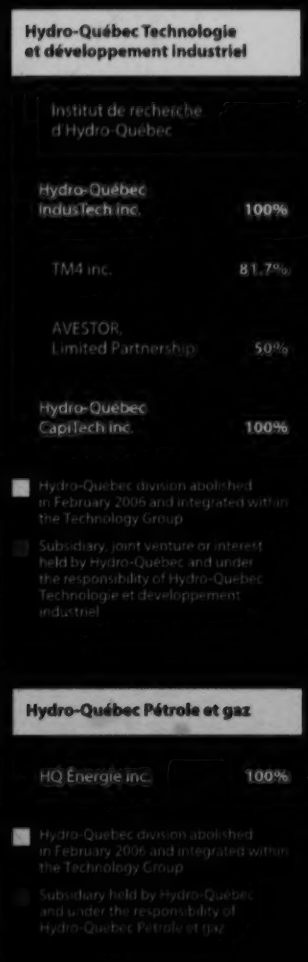
Subsidiary, joint venture or interest held by Hydro-Québec International

* *A minority shareholder holds 11% of the voting rights in this subsidiary through non-participating shares. Conversion into common shares is anticipated in 2006.*

TransÉnergie HQ inc. **100%**

TransÉnergie U.S. Ltd. **100%**

Hydro-Québec subsidiary


Hydro-Québec Technologie et développement industriel
Institut de recherche d'Hydro-Québec
Hydro-Québec IndusTech inc. 100%
TM4 inc. 81.7%
AVESTOR, Limited Partnership 50%
Hydro-Québec CapiTech inc. 100%
Hydro-Québec division abolished in February 2006 and integrated within the Technology Group
Subsidiary, joint venture or interest held by Hydro-Québec and under the responsibility of Hydro-Québec Technologie et développement industriel
Hydro-Québec Pétrole et gaz
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HYDRO-QUÉBEC TECHNOLOGIE ET DÉVELOPPEMENT INDUSTRIEL

The role of Hydro-Québec Technologie et développement industriel was to ensure the integrated management of technological innovation and to create value from Hydro-Québec technologies. The division consisted mainly of Hydro-Québec's research institute and the subsidiaries Hydro-Québec IndusTech and Hydro-Québec CapiTech.

Institut de recherche d'Hydro-Québec

Hydro-Québec's research institute provides technical assistance and carries out technological innovation projects to support the solid performance of the operating divisions. It focuses on Hydro-Québec's core businesses: the generation, transmission and distribution of electricity.

Hydro-Québec IndusTech

The mission of Hydro-Québec IndusTech is to partner with the private sector in the industrialization and marketing of technologies resulting from Hydro-Québec's research activities and offering new avenues for growth. Its portfolio currently comprises interests in AVESTOR and TM4.

Hydro-Québec CapiTech

The venture capital company Hydro-Québec CapiTech invests in energy businesses that market or are about to market promising technologies, thereby giving Hydro-Québec preferential access to outside innovations.

The Hydro-Québec Technologie et développement industriel division recorded a $170-million net loss in 2005, compared to a net loss of $155 million in 2004, a change of $15 million primarily due to a revaluation of its investment portfolio in 2005.

HYDRO-QUÉBEC PÉTROLE ET GAZ

The mission of Hydro-Québec Pétrole et gaz was to tap Eastern Quebec's oil and gas potential. It carried out exploration activities in partnership with businesses that have the financial capacity and the necessary expertise to successfully perform this work.

In 2005, the division recorded a net loss of $8 million, compared to net income of $292 million in 2004. The 2004 results were attributable to the sale of Hydro-Québec's interest in Noverco, presented under discontinued operations.

Investing activities

Investments affecting cash flow totaled $538 million in 2005. The development and purchase of information systems and telecommunications equipment accounted for most of this amount.

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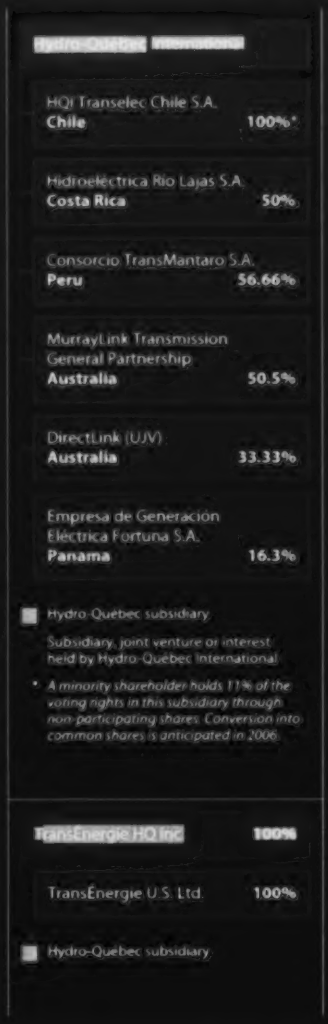
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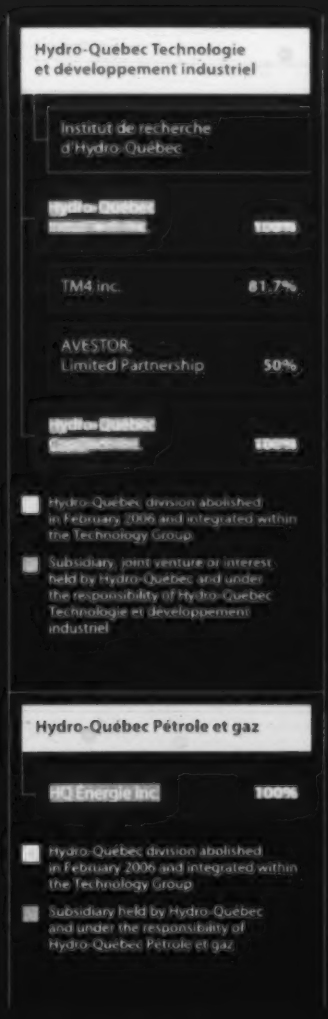
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Investing activities

Investments affecting cash flow totaled $58 million in 2005. The development and purchase of information systems and telecommunications equipment accounted for most of this amount.

Outlook

In 2006, net income for Hydro-Québec should be slightly higher than in 2005. Growth in revenue from domestic sales and from net sales outside Québec will be partially offset by higher pension expense and financial expense, as well as increased supply costs for Hydro-Québec Distribution. In this regard, the Distributor plans to meet most of its 2006 supply needs beyond the heritage pool by way of calls for tenders on short-term markets. Depreciation and amortization expense should fall, since the write-off of the Grande-Baleine draft-design study in 2005 was a one-time item. We will also continue the plan to sell off our foreign interests, most of which have been classified as discontinued operations.

Hydro-Québec intends to invest slightly more than $4 billion in 2006. Close to 60% of this amount will be devoted to development projects. In addition, we will continue to implement the program to increase security at our facilities, initiated in 2005. Based on debt maturities, cash from operations and the plan for creating value from our foreign holdings, our borrowing program will stand at less than $2 billion.

Hydro-Québec Production will continue to develop Québec's hydroelectric potential and to invest in its existing fleet. Work in progress will continue: completion and commissioning of Mercier and Eastmain-1 generating stations; construction of Péribonka generating station and the Chute-Allard and Rapides-des-Cœurs developments; completion of the draft-design studies for the Romaine complex; permitting for the Eastmain-1-A/Sarcelle/Rupert project; and refurbishment work on Beauharnois, Outardes-3, Outardes-4, Rapide-2, Rapide-7 and La Tuque generating stations.

Hydro-Québec TransÉnergie intends to commission the line de-icing equipment at Lévis substation and continue bringing output onto the power grid from new facilities, including Eastmain-1, Péribonka, Chute-Allard and Rapides-des-Cœurs generating stations and the wind farms to be built in the Gaspé region. The permanent connection of Eastmain-1 powerhouse and the commissioning of the Nemiscau–Waskaganish line are slated for 2006. At the same time, the division will continue to enhance service quality and the reliability and security of the power transmission system.

Hydro-Québec Distribution will focus on delivering reliable electricity, offering services adapted to its customers' priority expectations, and promoting energy efficiency. The division will therefore continue to invest in automating, reinforcing and securing the distribution grid in order to take care of demand growth and ensure long-term operability. It will also continue to deploy the CIS (Customer Information System) and the Energy Efficiency Plan, which is one of the measures taken by Hydro-Québec to ensure security of supply.

Management Report

Hydro-Québec's consolidated financial statements and all additional information contained in the Annual Report are the responsibility of Management and are approved by the Board of Directors. The consolidated financial statements have been prepared by Management in accordance with Canadian generally accepted accounting principles and in accordance with decisions handed down by the Régie de l'énergie with respect to the transmission and distribution of electricity. They include amounts determined based on Management's best estimates and judgment. Financial information presented elsewhere in the Annual Report is consistent with the information provided in the consolidated financial statements.

Management maintains an internal control system which includes communicating Hydro-Québec's code of ethics and a code of conduct to employees, primarily to ensure the proper management of resources and the orderly conduct of business. The objective of this system is to provide reasonable assurance that the financial information is pertinent and reliable and that the assets of Hydro-Québec are adequately recorded and safeguarded. An internal auditing process allows evaluation of the sufficiency and efficiency of control, as well as of Hydro-Québec's policies and procedures. Recommendations ensuing from this process are submitted to Management and the Audit Committee.

The Board of Directors is responsible for corporate governance. It assumes its responsibility for the consolidated financial statements principally through its Audit Committee, composed solely of independent directors, who do not hold full-time positions within the Corporation or in one of its subsidiaries. This committee's mandate is to ensure that the consolidated financial statements present fairly Hydro-Québec's financial position, the results of its operations and its cash flows. The Audit Committee meets regularly with Management, the General Auditor and the external auditors to discuss the results of their audits and their findings with respect to the integrity and the quality of the presentation of Hydro-Québec's financial information and the effectiveness of its internal control systems. The General Auditor and the external auditors have full and unrestricted access to the Audit Committee, with or without Management's presence.

The consolidated financial statements for 2005 have been audited by the external auditors, KPMG LLP and Ernst & Young LLP, who were appointed by the shareholder.

Michael L. Turcotte
Chairman of the Board

Thierry Vandal
President and
Chief Executive Officer

Daniel Garant
Executive Vice President,
Finance and
Chief Financial Officer

Montréal, Québec
February 10, 2006

Auditors' Report

To the Minister of Finance of Québec:

We have audited the consolidated balance sheet of Hydro-Québec as at December 31, 2005, and the consolidated statements of operations, retained earnings and cash flows for the year then ended. These financial statements are the responsibility of Hydro-Québec's Management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by Management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of Hydro-Québec as at December 31, 2005, and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the *Auditor General Act* (R.S.Q., c. V-5.01), we report that, in our opinion, except for the prospective application of changes in accounting policies described in Note 2 to the financial statements, these principles have been applied on a basis consistent with that of the preceding year.

The comparative information for 2004, prior to adjustments to reflect discontinued operations as described in Note 7 to the financial statements, was audited by other auditors, who expressed an unqualified opinion on these statements in their report dated March 16, 2005.

KPMG LLP

Chartered Accountants

Ernst & Young LLP

Chartered Accountants

Montréal, Québec
February 10, 2006

Consolidated Statements of Operations

Years ended December 31 In millions of Canadian dollars	Notes	2005	2004
Revenue		**10,890**	10,399
Expenditure			
Operations		**2,294**	2,216
Electricity and fuel purchases		**1,485**	1,465
Depreciation and amortization	4	**2,040**	1,870
Taxes	5	**602**	609
		6,421	6,160
Operating income		**4,469**	4,239
Financial expenses	6	**2,214**	2,111
Income from continuing operations before non-controlling interest		**2,255**	2,128
Non-controlling interest		**6**	3
Income from continuing operations		**2,249**	2,125
Discontinued operations	7	**3**	310
Net income		**2,252**	2,435

Consolidated Statements of Retained Earnings

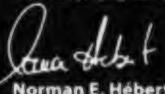
Years ended December 31 In millions of Canadian dollars	Note	2005	2004
Balance at beginning of year		**11,949**	10,864
Net income		**2,252**	2,435
		14,201	13,299
Dividends declared	20	**1,126**	1,350
Balance at end of year		**13,075**	11,949

The accompanying notes are an integral part of the consolidated financial statements.

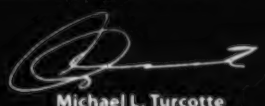
Consolidated Balance Sheets

As at December 31 In millions of Canadian dollars	Notes	2005	2004
ASSETS			
Property, plant and equipment	8	**50,588**	51,425
Current assets			
Cash and cash equivalents		**16**	97
Investments		**322**	72
Accounts receivable		**1,764**	1,943
Swaps and sinking funds	10	**685**	43
Materials, fuel and supplies		**343**	328
Assets held for sale	7	**145**	–
		3,275	2,483
Other long-term assets			
Investments	9	**221**	252
Swaps and sinking funds	10	**1,749**	1,671
Goodwill	11	**10**	79
Intangible assets	12	**639**	732
Other assets	13	**1,784**	1,476
Assets held for sale	7	**2,166**	–
		6,569	4,210
		60,432	58,118
LIABILITIES AND SHAREHOLDER'S EQUITY			
Long-term debt	14	**31,279**	32,567
Current liabilities			
Borrowings		**20**	53
Accounts payable and accrued liabilities		**1,929**	1,832
Dividends payable	20	**1,126**	1,350
Accrued interest		**927**	975
Current portion of long-term debt	14	**3,148**	1,950
Liabilities related to assets held for sale	7	**172**	–
		7,322	6,160
Asset retirement obligations	15	**282**	264
Other long-term liabilities	16	**2,548**	2,361
Long-term liabilities related to assets held for sale	7	**1,213**	–
Perpetual debt	17	**379**	391
Non-controlling interest		**33**	155
Shareholder's equity	20		
Share capital		**4,374**	4,374
Retained earnings		**13,075**	11,949
Translation adjustments		**(73)**	(103)
		17,376	16,220
		60,432	58,118
Commitments and contingencies	23		

The accompanying notes are an integral part of the consolidated financial statements.



Norman E. Hébert Jr.
Director and Member of the Audit Committee



Michael L. Turcotte
Chairman of the Board

Consolidated Statements of Cash Flows

Years ended December 31 In millions of Canadian dollars	Notes	2005	2004
Operating activities			
Income from continuing operations		**2,249**	2,125
Non-cash items			
Depreciation and amortization			
Property, plant and equipment		**1,688**	1,619
Intangible assets		**114**	106
Regulatory assets		**51**	50
Deferred charges		**16**	24
Discounts and other deferred credits related to long-term debt		**(200)**	(225)
Other		**237**	220
Change in non-cash working capital items	21	**268**	4
		4,423	3,923
Investing activities			
Property, plant and equipment and intangible assets		**(3,282)**	(3,072)
Long-term investments		**9**	113
Disposal of investments, net of divested cash and cash equivalents	7	**–**	894
Net change in short-term investments		**(251)**	159
Other		**(170)**	(64)
		(3,694)	(1,970)
Financing activities			
Issuance of long-term debt		**3,855**	1,916
Repayment of long-term debt at maturity and sinking fund redemption		**(1,955)**	(1,802)
Prepayment of long-term debt		**(757)**	(738)
Inflows resulting from credit risk management		**315**	110
Outflows resulting from credit risk management		**(950)**	(555)
Net change in short-term borrowings		**(24)**	(3)
Dividends paid		**(1,350)**	(965)
Other		**(1)**	78
		(867)	(1,959)
Change in foreign exchange on cash and cash equivalents		**(2)**	(5)
Cash flows from continuing operations		**(140)**	(11)
Cash flows from discontinued operations	7	**135**	(86)
Net change in cash and cash equivalents		**(5)**	(97)
Cash and cash equivalents at beginning of year		**97**	194
Cash and cash equivalents at end of year		**92**	97
Cash and cash equivalents			
Continuing operations		**16**	97
Discontinued operations		**76**	–
		92	97
Supplementary cash flow information	21		

The accompanying notes are an integral part of the consolidated financial statements.

Years ended December 31, 2005 and 2004
Amounts in tables are in millions of Canadian dollars, unless otherwise indicated

Under the provisions of the Hydro-Québec Act, the government corporation Hydro-Québec (the "Corporation") is mandated to supply power and to pursue endeavors in energy-related research and promotion, energy conversion and conservation, and any field connected with or related to power or energy. The Corporation is required, in particular, to supply a base volume of up to 165 TWh a year of heritage pool electricity for the Québec market, as set out in the Act respecting the Régie de l'énergie.

Note 1 Significant Accounting Policies

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) and reflect the accounting procedures and practices that are generally accepted by the Régie de l'énergie (the "Régie"). Given that these procedures and practices are taken into account in the consolidated financial statements, the timing of the recognition of certain costs in consolidated operations is modified, resulting in the recognition of regulatory assets.

Regulation

The *Act respecting the Régie de l'énergie* grants the Régie exclusive authority to determine or modify the rates and conditions under which electricity is transmitted and distributed by the Corporation. Consequently, the Corporation's electricity transmission and distribution activities in Québec are said to be regulated. Under this legislation, rates are set by reasoned decision of three commissioners after public hearings. Moreover, this Act stipulates that rates are determined on a basis that allows for recovery of the cost of service plus a fair return on the rate base.

The Régie and the Corporation both belong to the government of Québec reporting entity. However, the Régie is an independent, quasi-judicial economic regulatory body accountable to the National Assembly of Québec through the Minister of Natural Resources and Wildlife.

TRANSMISSION

The Corporation's power transmission rates were determined in decision D-2002-95, handed down by the Régie in April 2002. In this decision, the Régie granted a return of 9.72% on the rate base, assuming a capital structure with 30% shareholder's equity.

DISTRIBUTION

The Corporation's electricity rates were determined in decisions D-2004-57 and D-2005-48, in which the Régie granted across-the-board rate increases of 1.41% and 1.2%, effective April 1, 2004, and April 1, 2005, respectively. The return on the rate base granted by the Régie to the Distributor and set at 7.99% in 2004 increased to 8.4% in 2005, assuming a capital structure with 35% shareholder's equity.

INTERNATIONAL ACTIVITIES

A substantial portion of Hydro-Québec International's revenue is derived from activities for which rates are regulated according to different economic models by the regulatory bodies in the countries where the activities are carried on.

Consolidation

The consolidated financial statements include the accounts of the Corporation, its subsidiaries and its joint ventures as well as those of variable interest entities (VIEs) where Hydro-Québec is the primary beneficiary (referred to collectively as Hydro-Québec). Interests in joint ventures are accounted for using the proportionate consolidation method. Investments in companies over which Hydro-Québec can exercise significant influence are accounted for on an equity basis.

Hydro-Québec also holds an interest in a venture capital company whose mission is to make strategic investments. The investments held by this company, which would normally be consolidated or accounted for at equity value or at cost, are accounted for at fair value. The fair value is determined according to the quoted market price at the balance sheet date in the case of listed shares, and according to valuation methods recognized by the financial markets in the case of unlisted shares. Other long-term investments are recorded at cost.

The operations and cash flows of Hydro-Québec International's holdings are consolidated with a one-quarter lag. The financial position disclosed in Hydro-Québec's consolidated balance sheet for such holdings is as at September 30. If significant transactions or events occur during the fourth quarter, they are reflected in Hydro-Québec's consolidated financial statements for its fiscal year.

Use of estimates

The preparation of consolidated financial statements in accordance with GAAP requires that Management make estimates and assumptions that affect the amounts recognized as assets and liabilities, required disclosures regarding contingent assets and liabilities at the date of the consolidated financial statements and the amounts of revenue and expenditure recorded for the years in question. The estimates relate to unbilled electricity deliveries, the useful life of property, plant and equipment, goodwill, asset retirement obligations and employee future benefits, among other things. Actual results could differ from those estimates.

Revenue

Revenue is recognized when electricity is delivered or services are rendered. Revenue from sales of electricity in Québec is recorded on the basis of cyclical billings and also includes revenue accrued in respect of unbilled electricity deliveries.

Income taxes

In Canada, the Corporation and most of its holdings are exempt from paying income taxes since they are government-owned. Entities operating in foreign countries pay income taxes according to the tax rules in effect in the country where they derive revenue and the application of a tax treaty between Canada and the country concerned, if any such treaty exists.

The taxable entities use the liability method to account for income taxes.

Foreign currency translation

SELF-SUSTAINING FOREIGN OPERATIONS

The financial statements of foreign operations that are self-sustaining in terms of financial and operational management are translated according to the current rate method using the foreign currency as the measuring unit. Under this method, assets and liabilities are translated into Canadian dollars at the exchange rate in effect at the balance sheet date, and revenue and expenditure are translated at the average exchange rates in effect during the period. Exchange gains or losses resulting from the translation of the financial statements of these foreign operations are presented under Translation adjustments in Shareholder's equity on the balance sheet.

INTEGRATED FOREIGN OPERATIONS AND FOREIGN CURRENCY TRANSACTIONS

In the case of foreign operations that are integrated in terms of financial and operational management, as well as foreign currency transactions, accounts stated in foreign currencies are translated according to the temporal method. Under this method, monetary assets and liabilities are translated into Canadian dollars at the exchange rate in effect at the balance sheet date and non-monetary items are translated at the historical rate. Revenue and expenditure resulting from foreign currency transactions are generally translated into Canadian dollars at the average exchange rates in effect during the period.

The exchange gains or losses resulting from the translation of monetary items are included in the statement of operations, unless they relate to hedging items for future sales in U.S. dollars, in which case they are deferred to the year such sales are made in accordance with Accounting Guideline 13 of the *Canadian Institute of Chartered Accountants (CICA) Handbook*, Hedging Relationships.

Property, plant and equipment

Property, plant and equipment are carried at cost, which comprises materials, labor, other costs directly related to construction activities, and financial expenses capitalized during construction. Property, plant and equipment also include the discounted value of asset retirement obligations. Contributions from third parties are applied against the cost of the related property, plant and equipment.

Financial expenses capitalized to property, plant and equipment under construction are determined using the average cost of long-term debt of the Corporation at the end of the previous year. When the property, plant and equipment under construction relate to regulated transmission and distribution activities, such financial expenses take return on shareholder's equity into account. The portion that corresponds to return on shareholder's equity is included in Revenue in the consolidated statement of operations.

The cost of property, plant and equipment under construction is transferred to property, plant and equipment in service when construction is completed and the facilities are commissioned.

Property, plant and equipment are depreciated over their useful lives, primarily using the sinking fund method, at a rate of 3%. Under the *Hydro-Québec Act*, the depreciation period is a maximum of 50 years. The depreciation periods for the principal categories of property, plant and equipment are as follows:

Hydraulic generation	40 to 50 years
Thermal generation, including nuclear	15 to 30 years
Transmission substations and lines	30 to 50 years
Distribution substations and lines	25 to 40 years

When unregulated property, plant and equipment are retired, the cost of such assets and the cost of their dismantlement, net of accumulated depreciation and salvage value, are charged to operations for the year. When regulated property, plant and equipment are retired, these costs are charged to a separate account and depreciated over a maximum period of 10 years, using the sinking fund method, at a rate of 3%.

Maintenance and repair costs are charged to operations as incurred.

Impairment of long-lived assets

Hydro-Québec reviews the carrying value of its property, plant and equipment and its amortizable intangible assets whenever events or changes in circumstances indicate that the expected undiscounted net cash flows could be lower than the carrying value of the property and assets. An impairment loss corresponding to the amount by which the carrying value exceeds fair value is recognized, if applicable.

Cash, cash equivalents and short-term investments

Cash and cash equivalents comprise cash on hand and liquid short-term investments with a maturity of three months or less from the date of acquisition. Investments with a maturity of three to 12 months are disclosed separately under Current assets in the balance sheet.

Short-term investments are recorded at the lower of unamortized cost and fair value.

Materials, fuel and supplies

Inventories of materials, fuel and supplies are valued at the lower of cost and net realizable value. Cost is determined by the average cost method.

Discounts and other deferred credits related to long-term debt

Discounts and other deferred credits related to long-term debt are deferred and amortized over the terms of the loans on a straight-line basis.

Employee future benefits

The Corporation offers all of its employees a contributory defined-benefit pension plan based on final pay, as well as other post-retirement and post-employment benefits.

The cost of pension benefits and other post-retirement benefits provided in exchange for services rendered during the year is calculated using the projected benefit method prorated on years of service. It is based on Management's best assumptions of expected plan asset performance, salary escalation, the increase in health care costs, retirement ages of employees and other actuarial factors.

In order to establish its employee future benefit obligations, the Corporation has adopted the following policies:

- Past service costs arising from plan amendments and transitional balances relating to the Pension Plan and post-retirement benefits as at January 1, 1999, are amortized over periods not exceeding employees' average remaining years of service, which totaled 13 years as at January 1, 2005 (13 years as at January 1, 2004), using the straight-line method.
- Amortization of actuarial gains or losses is charged to operations for the year if the unamortized net actuarial gain or loss at the beginning of the year exceeds 10% of the value of the accrued benefit obligations or 10% of the market-related value of the plan assets, whichever is greater. The amortization corresponds to the excess divided by employees' expected average remaining years of service.
- The expected return on Pension Plan assets is based on a market-related value determined by using a five-year moving average for equity securities and by valuing other asset classes at their fair value.
- The value of the benefit resulting from the difference, for the year, between contributions actually paid by employees and their average contributions projected over the employees' expected average remaining years of service is applied against the service cost as contributions deemed paid. This amount is amortized using the method for amortizing actuarial gains and losses.

Goodwill and intangible assets

The excess of the cost of investments in subsidiaries and joint ventures over the proportionate share of the fair value of net assets acquired is recorded as goodwill. Intangible assets are recorded at cost.

Goodwill and intangible assets with indefinite useful lives are not amortized. These assets are tested for impairment annually or more frequently if events indicate a potential impairment in value. The excess of the carrying amount over the fair value is recorded in the statement of operations for the period in which the impairment is determined.

Intangible assets with finite useful lives are amortized over their useful lives. The amortization methods and periods used for these assets are as follows:

Software, licences and patents	straight-line and sinking fund at 3%	3 to 20 years
Rights	sinking fund at 3%	40 years
Environmental studies	sinking fund at 3%	5 years

Note 1 | Significant Accounting Policies (continued)

Sinking funds

Sinking funds are made up of Hydro-Québec debentures, Government of Canada bonds, or bonds issued or guaranteed by the Québec government. The Corporation's debentures are deducted from long-term debt, while the other securities are presented under Swaps and sinking funds.

Sinking fund securities are carried at unamortized cost. The difference between the cost and the par value at maturity is amortized over the remaining term of the security.

Derivative instruments

As part of its integrated risk management, Hydro-Québec uses various derivative instruments to manage foreign exchange, interest rate and market risk, including exposure to fluctuating energy and raw-material prices. In the case of hedging operations, the Corporation formally documents all relationships between hedging instruments and hedged items. This process involves associating all derivative instruments with specific assets and liabilities on the balance sheet, or with forecast or likely transactions. The Corporation also formally measures the effectiveness of hedging relationships at inception and then quarterly thereafter.

Derivative instruments designated as hedges in effective hedging relationships are accounted for using hedge accounting. The different types of hedging relationships in which the Corporation engages are as follows:

MANAGEMENT OF RISK ASSOCIATED WITH U.S.-DOLLAR SALES AND LONG-TERM DEBT

- Foreign exchange risk – Currency swaps used to manage exchange risk related to long-term debt and sales in U.S. dollars are translated at the closing exchange rates in effect at the balance sheet date. Debit balances are reported as Swaps and sinking funds, while credit balances are presented as Long-term debt. Gains or losses on currency swaps related to payments on long-term debt are included in the statement of operations under Financial expenses, while gains or losses on currency swaps related to sales in U.S. dollars are deferred to maturity and recognized in the statement of operations under Financial expenses in the year in which the sales are made.

- Interest rate risk – Interest rate swaps used to modify long-term exposure to interest rate risk are accounted for on an accrual basis and are presented in the statement of operations under Financial expenses. The corresponding amounts payable or receivable are recorded as adjustments to accrued interest.

MANAGEMENT OF SHORT-TERM FINANCIAL RISK

- Foreign exchange risk – To manage short-term foreign exchange risk, the Corporation transacts options and forwards, which are recorded at cost. Gains or losses realized on these instruments are deferred and recognized in the statement of operations in the same period as the hedged item.

- Interest rate risk – The Corporation uses options, swaps and forward rate agreements to manage short-term interest rate risk. The instruments are accounted for at cost, and the related realized gains or losses are deferred and charged to operations in the same period as the hedged item.

- Market risk – To manage market risk exposure, the Corporation contracts mainly options, commodity swaps and commodity futures. Risk management instruments for energy or aluminum prices are accounted for at cost, and the related gains or losses are deferred and charged to operations on a basis consistent with the recognition of gains and losses from the underlying reverse risk position.

If a derivative instrument no longer satisfies hedging conditions or is sold or liquidated, or if Hydro-Québec terminates its designation as a hedging relationship, hedge accounting ceases to be applied on a prospective basis. The fair value of the derivative instrument is then recorded and deferred to be included in the statements of operations in the periods in which the hedged item affects operations. Should the hedged item cease to exist, the gains or losses previously deferred are immediately charged to operations.

For derivative instruments to which hedge accounting cannot be applied, realized and unrealized changes in fair value are charged to operations in the periods in which they occur.

The fair value of derivative instruments is based on the spot rates or on the forward rates or prices in effect at market closing at the balance sheet date. In the absence of this information for a given instrument, Management uses the available forward rate or price for an equivalent instrument. In the case of options, valuation models recognized by financial markets are used to estimate the fair value.

Asset retirement obligations

The Corporation accounts for asset retirement obligations in the period in which these legal obligations are incurred when a reasonable estimate of their fair value can be made. The corresponding costs of asset retirement are added to the carrying amount of the related asset and are amortized over its useful life. In subsequent fiscal years, any change due to the passage of time is charged to operating expenses for the current year (accretion expense) and the corresponding amount is added to the carrying value of the liability. Changes resulting from revisions to the timing or the amount of the undiscounted cash flows are recognized as an increase or decrease in the carrying value of the liability under asset retirement obligations, and the corresponding retirement cost adjustment is accounted for as part of the carrying amount of the related asset.

The cash flows required to settle obligations are estimated on the basis of studies that use various assumptions concerning the methods and timing to be adopted for the retirement of the property, plant and equipment. The Corporation periodically reviews the valuation of these cash flows in light of the underlying assumptions and estimates, possible technological advances, and changes in the standards and regulations governing the decommissioning of nuclear generating stations.

Comparative information

Certain figures of the previous year have been reclassified in order to conform to the presentation adopted in the current year.

Note 2 | Changes to Accounting Policies

Recent changes

2005

INVESTMENT COMPANIES

On January 1, 2005, Hydro-Québec prospectively adopted the recommendations in CICA Accounting Guideline 18, Investment Companies. Under this Guideline, investment companies are required to account for their investments at fair value in certain cases where these investments would normally have been consolidated or accounted for on an equity basis or at cost. Criteria are provided to determine whether a company should be classified as an investment company. Companies not meeting the criteria will be required to comply with the requirements for consolidation or for accounting using the equity method. The Guideline also provides instructions for circumstances where fair value must be used in the consolidated financial statements of the parent company or the entity exercising significant influence over the investment company. Since the adoption of this Guideline, the venture capital investments held by a subsidiary have been accounted for at fair value. They were previously accounted for at cost. The adoption of these recommendations did not have a significant impact on the consolidated financial statements.

CONSOLIDATION OF VARIABLE INTEREST ENTITIES

On January 1, 2005, Hydro-Québec retroactively applied the recommendations in CICA Accounting Guideline 15, Consolidation of Variable Interest Entities, without restating the figures for the preceding year. This Guideline provides the consolidation principles applicable to certain entities (VIEs) over which control is exercised other than through voting rights. It prescribes consolidation of an entity when the reporting enterprise is the primary beneficiary. The primary beneficiary is the enterprise with variable interests that will absorb a majority of the VIE's expected losses, receive a majority of its expected residual returns, or both. The Guideline also requires disclosure of certain information when the reporting enterprise has a significant variable interest in a VIE that it has not consolidated. The adoption of these recommendations did not have a significant impact on the consolidated financial statements.

DETERMINING WHETHER AN ARRANGEMENT CONTAINS A LEASE

On January 1, 2005, Hydro-Québec adopted the recommendations in EIC-150 released by the CICA's Emerging Issues Committee, entitled Determining Whether an Arrangement Contains a Lease. This abstract provides guidance for determining whether an arrangement comprising a transaction or a series of related transactions that does not take the legal form of a lease but conveys a right to use a tangible asset in return for a payment or series of payments is within the scope of *CICA Handbook* Section 3065, Leases. The provisions in the abstract apply to arrangements agreed to, committed to, modified or acquired in a business combination, beginning January 1, 2005. The adoption of these recommendations did not have a significant impact on the consolidated financial statements.

DISCLOSURES BY ENTITIES SUBJECT TO RATE REGULATION

On December 31, 2005, Hydro-Québec adopted the recommendations in CICA Accounting Guideline 19, Disclosures by Entities Subject to Rate Regulation. The Guideline recommends that the existence and nature of all forms of rate regulation, as well as their effects on the consolidated financial statements, should be disclosed in the notes to the consolidated financial statements.

2004

HEDGING RELATIONSHIPS

On January 1, 2004, Hydro-Québec prospectively adopted the recommendations of CICA Accounting Guideline 13, Hedging Relationships. This Guideline establishes the conditions for applying hedge accounting. It deals in detail with the identification, designation, documentation and effectiveness of hedging relationships, as well as the discontinuance of hedge accounting. Hedge accounting is applied to derivative instruments used in risk management that conform to hedge accounting eligibility requirements, as described in Note 1. Changes in the fair value of derivative instruments that do not comply with these requirements are charged to operations.

As a result of the adoption of the Guideline, hedging relationships that were no longer eligible for hedge accounting were recorded in accordance with the transitional provisions. The difference between the carrying amount and the fair value of a derivative instrument used in these hedging relationships was deferred and is recognized in the statement of operations in the same period as the corresponding gains, losses, revenue or expenditure related to the original hedged item. Accordingly, for hedging relationships canceled as at January 1, 2004, the recognition in the balance sheet of derivative instruments at fair value led to the recording of a deferred loss of approximately $65 million.

IMPAIRMENT OF LONG-LIVED ASSETS

On January 1, 2004, Hydro-Québec prospectively adopted the recommendations of *CICA Handbook* Section 3063, Impairment of Long-Lived Assets. This section establishes standards for the recognition, measurement and disclosure of the impairment of long-lived assets, and further states that a long-lived asset must be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. The test for recoverability is based on a comparison between the carrying amount of the asset and the expected undiscounted net cash flows which are directly associated with the asset and may result from its use or eventual disposal. If the expected undiscounted net cash flows are less than the carrying amount, an impairment loss corresponding to the amount by which the carrying amount exceeds the fair value is recognized, and the fair value then becomes the new cost base of the asset. Fair value is based on discounted future cash flows if market prices are not available. The adoption of these standards did not have any impact on the consolidated financial statements.

ASSET RETIREMENT OBLIGATIONS

On January 1, 2004, Hydro-Québec adopted the recommendations of *CICA Handbook* Section 3110, Asset Retirement Obligations. This standard requires the recognition and measurement of liabilities for legal obligations associated with the retirement of property, plant and equipment. The liability associated with an asset retirement obligation is measured initially at its fair value in the period in which the obligation is incurred, if a reasonable estimate of fair value can be made. A corresponding retirement cost is added to the carrying amount of the related asset and is amortized over its useful life. In subsequent periods, the liability is adjusted to reflect any changes due to the passage of time and to revisions made to the timing of the asset retirement or to the amount of undiscounted cash flows as compared to the original estimate. In accordance with the standard, Hydro-Québec applied these changes retroactively and the figures for the previous year were restated.

The adoption of this standard did not significantly affect net income for 2004. Property, plant and equipment and asset retirement obligations as at December 31, 2004, increased by $43 million and $59 million, respectively.

EMPLOYEE FUTURE BENEFITS

On June 30, 2004, Hydro-Québec adopted the changes to *CICA Handbook* Section 3461, Employee Future Benefits, concerning the disclosure of supplementary information intended to help the users of financial statements gain a better understanding of companies' obligations with respect to employee future benefits.

GENERALLY ACCEPTED ACCOUNTING PRINCIPLES AND GENERAL STANDARDS OF FINANCIAL STATEMENT PRESENTATION

On January 1, 2004, Hydro-Québec adopted the recommendations of *CICA Handbook* Sections 1100 and 1400, respectively, Generally Accepted Accounting Principles and General Standards of Financial Statement Presentation. Section 1100 describes what constitutes GAAP and the sources thereof. It also provides guidance on sources to consult when selecting accounting policies and determining appropriate disclosures, in cases where a matter is not dealt with explicitly in the primary sources of GAAP, thus establishing a new Canadian GAAP hierarchy. Section 1400 provides general instructions on financial statement presentation, and specifies what constitutes fair presentation in accordance with GAAP. The adoption of these standards did not have any impact on the consolidated financial statements.

Note 2 Changes to Accounting Policies (continued)

Future changes

NON-MONETARY TRANSACTIONS

The CICA has released *CICA Handbook* Section 3831, Non-monetary Transactions, which supersedes Section 3830, also entitled Non-monetary Transactions. This standard requires that a non-monetary asset or liability exchanged or transferred in a non-monetary transaction should be measured at its fair value where the criterion of "commercial substance" is met. The new provisions apply to all non-monetary transactions initiated in periods beginning on or after January 1, 2006. The adoption of the recommendations in this new Section is not expected to have any significant impact on the consolidated financial statements.

FINANCIAL INSTRUMENTS, HEDGES AND COMPREHENSIVE INCOME

In 2005, the CICA released Handbook sections 3855, 3865 and 1530, respectively entitled Financial Instruments – Recognition and Measurement, Hedges and Comprehensive Income.

Section 3855 specifies when a financial instrument should be accounted for on the balance sheet and at what amount: in some cases at fair value, while in other cases at a value based on cost. It also specifies how gains and losses on financial instruments should be presented.

Section 3865 replaces the guidance for hedging relationships that previously was included in Accounting Guideline 13, in particular the guidance for the designation and documentation of hedging relationships. These new recommendations specify how hedge accounting is applied and the required disclosures to be made by an entity applying hedge accounting.

Section 1530 establishes standards for the presentation and disclosure of comprehensive income. Comprehensive income for a reporting period includes, in addition to net income, the entire change in net assets attributable to transactions and other events from non-owner sources. Comprehensive income and its components will have to be presented in a financial statement with the same prominence as the other financial statements.

These sections will apply to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2007. The Corporation is currently examining the impact on its consolidated financial statements of applying these new standards.

Note 3 Effects of Rate Regulation on the Consolidated Financial Statements

The following information describes the impacts on the consolidated financial statements of accounting practices adopted by the Corporation in accordance with decisions handed down by the Régie with respect to regulated activities.

Regulatory assets

Regulatory assets refer to costs incurred during the year or the preceding years that the Corporation expects to recover from customers through the rate-setting process. The following table presents the net carrying amounts of these assets as at December 31:

	Expected years of recovery	2005	2004
Net costs related to retirement of property, plant and equipment and intangible assets	2006–2015	**258**	239
Costs related to the Energy Efficiency Plan	2006–2010	**131**	51
Costs related to the rescission of dual-energy Rate BT	2006–2011	**76**	21
Costs related to a major discontinued project	2006–2007	**20**	–
Cost variance related to electricity purchases in excess of heritage pool	Conditions to be determined by the Régie	**13**	–
		498	311

NET COSTS RELATED TO RETIREMENT OF PROPERTY, PLANT AND EQUIPMENT AND INTANGIBLE ASSETS

When property, plant and equipment or intangible assets are retired, the cost of such assets, net of accumulated depreciation, and the associated cost of dismantlement, net of salvage value in the case of assets that are not replaced, are charged to a separate account and depreciated over a maximum period of 10 years, using the sinking fund method at a rate of 3%. The Régie authorized this accounting practice in decisions D-2002-95 and D-2003-93, which relate to the Corporation's power transmission and distribution activities, respectively. Were these activities not regulated, the related costs would be charged to operations for the year, and net income for 2005 would have been reduced by $19 million.

COSTS RELATED TO THE ENERGY EFFICIENCY PLAN

The costs related to implementation of the plan, such as specific energy conservation programs, are charged to a separate account and amortized over five years on a straight-line basis. This period begins in the year after the costs were recorded. For costs charged to this account, the financial expenses are capitalized at the authorized rate of return on the rate base until such time as they are included in the rate base and amortization begins. This accounting practice relates to the Corporation's power distribution activities and is authorized by the Régie in decisions D-2002-25 and D-2002-288. Were these activities not regulated, the costs of implementing the plan would be charged to operations in the year in which they are incurred, and net income for 2005 would have been reduced by $80 million.

COSTS RELATED TO THE RESCISSION OF DUAL-ENERGY RATE BT

The costs incurred in relation to the rescission of dual-energy Rate BT are charged to a separate account and will be amortized on a straight-line basis over five years starting April 1, 2006. These costs mainly include the deficit resulting from the variance between the supply cost recognized by the Régie and energy prices in effect, multiplied by the quantity of electricity delivered to customers at Rate BT, between January 1, 2004, and March 31, 2006. For costs charged to this account, the financial expenses are capitalized at the authorized rate of return on the rate base until amortization begins. This accounting practice was authorized by the Régie in decisions D-2004-47 and D-2004-170, which relate to the Corporation's power distribution activities. Were these activities not regulated, the related costs would be charged to operations in the year in which they are incurred, and net income for 2005 would have been reduced by $55 million.

COSTS RELATED TO A MAJOR DISCONTINUED PROJECT

A power transmission system project was discontinued in 2005. The costs deemed to be unrecoverable are deferred and amortized over three years on a straight-line basis. The Régie authorized this accounting practice in decision D-2002-95, which relates to the Corporation's power transmission activities. Were these activities not regulated, the related costs would be charged to operations for the year, and net income for 2005 would have been reduced by $20 million.

COST VARIANCE RELATED TO ELECTRICITY PURCHASES IN EXCESS OF HERITAGE POOL

Starting January 1, 2005, volume and price variances between the actual costs of electricity purchases in excess of the heritage pool and the costs forecast in the rate cases are accounted for in a separate account. For variances charged to this account, the financial expenses are capitalized at the authorized rate of return on the rate base until they are recognized in the statement of operations. The Régie has not yet determined how the account balance should be treated. The Régie authorized this accounting practice in decisions D-2005-34 and D-2005-132, which relate to the Corporation's power distribution activities. Were these activities not regulated, the related variances would be charged to operations in the year in which they are recognized, and net income for 2005 would have been reduced by $13 million.

RISKS AND UNCERTAINTIES

The risks and uncertainties related to the above regulatory assets are subject to periodic monitoring and assessment. When the Corporation considers that the value of these regulatory assets is no longer likely to be recovered by way of future rate adjustments, the carrying amount of these assets is charged to operations in the year in which this judgment is made.

Other regulatory practices

Under Régie decisions D-2002-95 and D-2003-93, the compensation granted by the government for the 1998 ice storm was applied against the cost of new property, plant and equipment constructed; it is amortized over the remaining lives of the retired assets, with the exception of the portion equivalent to the unamortized cost of these assets, which is amortized over 10 years. The sinking fund method, at a rate of 3%, is used in both cases. If GAAP were followed, the compensation would be amortized over the useful lives of the new property, plant and equipment constructed.

In decisions D-2002-95 and D-2004-47, the Régie prescribed capitalizing financial expenses to property, plant and equipment and intangible assets in progress according to the authorized rates of return on the rate bases. These rates, which are set using methods approved by the Régie, take into account a component associated with the cost of the debt and a component associated with the return on shareholder's equity, which would not be the case if activities were not regulated.

Under Régie decisions D-2002-95 and D-2003-93, the cost of dismantling assets that were retired and replaced, net of the salvage value, is added to the cost of the new assets constructed. If GAAP were followed, these costs would be charged to operations.

Note 4 Depreciation and Amortization

	2005	2004
Depreciation and amortization		
Property, plant and equipment	**1,688**	1,619
Intangible assets	**114**	106
Regulatory assets	**51**	50
Write-off of projects	**135**	41
Other	**52**	54
	2,040	1,870

Note 5 Taxes

	2005	2004
Capital tax	**330**	324
Tax on public services[a]	**229**	–
Tax on gross revenue	**–**	249
Municipal, school and other taxes	**43**	36
	602	609

a) Replaces the tax on gross revenue.

Note 6 Financial Expenses

	2005	2004
Interest		
Interest on debt securities	**2,303**	2,374
Amortization of discounts and borrowing expenses	**28**	34
	2,331	2,408
Exchange gain	**(1)**	(218)
Loan guarantee fees[a]	**156**	162
	155	(56)
Less		
Capitalized financial expenses	**249**	226
Net investment income	**23**	15
	272	241
	2,214	2,111

a) Guarantee fees paid to the shareholder.

Note 7 Discontinued Operations and Assets Held for Sale

On July 15, 2005, Hydro-Québec concluded the sale of the principal assets held by its subsidiary HydroSolution, Limited Partnership, for a cash consideration of $92 million, resulting in a gain on disposal of $48 million. At the time of disposal, these assets included property, plant and equipment totaling $42 million. HydroSolution is part of the Distribution segment for the purpose of presenting segmented information.

In the third quarter of 2005, Hydro-Québec presented the assets and liabilities of its stake in Cross-Sound Cable Company, LLC, which is classified under Corporate and Other Activities for the purpose of presenting segmented information, as being held for sale. On November 8, 2005, it concluded the sale of this subsidiary for US$160 million, subject to certain conditions. The transaction provides for the disposal of the units held and repayment of the loan granted by Hydro-Québec to Cross-Sound Cable Company, LLC.

Hydro-Québec also adopted a plan to sell its integrated foreign interests, which are classified under Corporate and Other Activities for the purpose of presenting segmented information. Consequently, the related assets and liabilities have been classified as being held for sale.

On June 30, 2004, Hydro-Québec sold its interest in Noverco Inc., for a cash consideration of $900 million, resulting in a gain on disposal of $265 million.

The following table presents operating results and cash flows from interests presented as discontinued operations:

	2005	2004
Operations		
Revenue	**344**	1,135
(Loss) income before gains on disposal	**(45)**	45
Gains on disposal	**48**	265
Income from discontinued operations	**3**	310
Cash flows		
Operating activities	**105**	226
Investing activities	**44**	(234)
Financing activities	**(22)**	(85)
Change in foreign exchange on cash and cash equivalents	**8**	7
Cash flows from discontinued operations	**135**	(86)

The assets and liabilities of operations sold, as at the disposal date, were as follows:

	2005	2004
Cash and cash equivalents	**–**	6
Other current assets	**–**	155
Long-term assets	**42**	1,491
Current liabilities	**–**	137
Long-term liabilities	**–**	1,169
	42	346

Note 8 Property, Plant and Equipment

				2005
	In service	Accumulated depreciation	Under construction	Total
Generation				
Hydraulic	28,727	7,209	3,528	**25,046**
Thermal, including nuclear	2,538	1,614	95	**1,019**
Other	781	315	26	**492**
	32,046	9,138	3,649	**26,557**
Transmission				
Substations and lines	19,511	5,689	527	**14,349**
Other	2,042	1,120	72	**994**
	21,553	6,809	599	**15,343**
Distribution				
Substations and lines	10,463	3,620	219	**7,062**
Other	1,923	1,118	285	**1,090**
	12,386	4,738	504	**8,152**
Construction	51	34	2	**19**
Corporate and Other Activities	1,261	778	34	**517**
	67,297	21,497	4,788	**50,588**

			2004	
	In service	Accumulated depreciation	Under construction	Total
Generation				
Hydraulic	27,523	6,737	3,235	24,021
Thermal, including nuclear	2,515	1,479	74	1,110
Other	806	326	21	501
	30,844	8,542	3,330	25,632
Transmission				
Substations and lines	19,031	5,311	510	14,230
Other	2,183	1,241	29	971
	21,214	6,552	539	15,201
Distribution				
Substations and lines	10,104	3,310	176	6,970
Other	2,047	1,218	184	1,013
	12,151	4,528	360	7,983
Construction	63	48	9	24
Corporate and Other Activities	3,531	1,010	64	2,585
	67,803	20,680	4,302	51,425

As at December 31, 2005, the Corporation had cumulative costs related to suspended draft-design studies totaling $37 million ($219 million as at December 31, 2004). These costs, for which financial expenses are not capitalized, are presented as property, plant and equipment under construction. As the Corporation anticipates carrying out some of these projects in the longer term, it periodically reviews the cumulative costs of these draft-design studies. During such reviews, Management must use estimates and make assumptions that have an impact on the amounts reported for draft-design studies at the balance sheet date. The projects are assessed in terms of eventual profitability based on the expected prevailing market conditions at the time of their commissioning, compliance with sustainable development principles and how well they are received by local communities. A significant change in the assessment based on these criteria could result in a reduction of the balance for draft-design studies.

Note 9 Investments

	Note	2005	2004
At cost			
Churchill Falls (Labrador) Corporation Limited			
Bonds[a]	23	**54**	55
Other		**63**	72
		117	127
At fair value			
Venture capital[b] (at cost in 2004)		**49**	72
		49	72
At equity			
Churchill Falls (Labrador) Corporation Limited	23	**60**	53
CITEQ inc.		**(5)**	–
		55	53
		221	252

a) These bonds are secured by a general mortgage bearing interest at 7.5%, due in 2010, par value of $59 million in 2005 ($60 million in 2004).

b) The fair value of venture capital was $67 million as at December 31, 2004. Both the gross and net unrealized losses on investments held by the venture capital company amounted to $26 million as at December 31, 2005. Net gains of $6 million were realized in 2005.

Note 10 Swaps and Sinking Funds

	2005	2004
Swaps	**2,434**	1,710
Sinking funds	**–**	4
	2,434	1,714
Less		
Current portion	**685**	43
	1,749	1,671

Note 11 Goodwill

The changes in the carrying amount of goodwill by segment are as follows:

	2005		
	Generation	Corporate and Other Activities	Total
Balance at beginning of year	10	69	**79**
Change in foreign exchange	–	4	**4**
Write-off	–	(1)	**(1)**
Transfers to assets held for sale	–	(72)	**(72)**
Balance at end of year	10	–	**10**

	2004		
	Generation	Corporate and Other Activities	Total
Balance at beginning of year	10	288	298
Change in foreign exchange	–	1	1
Disposal of interest	–	(220)	(220)
Balance at end of year	10	69	79

Note 12 Intangible Assets

	2005		
	Cost	Accumulated amortization	Net carrying value
Subject to amortization			
Software, licences and patents	809	584	**225**
Rights	110	37	**73**
Environmental studies	126	109	**17**
	1,045	730	**315**
Not subject to amortization			
Servitudes			**324**
			639

	2004		
	Cost	Accumulated amortization	Net carrying value
Subject to amortization			
Software, licences and patents	753	493	260
Rights	111	35	76
Environmental studies	121	102	19
	985	630	355
Not subject to amortization			
Servitudes			377
			732

Note 13 | Other Assets

	Notes	2005	2004
Accrued benefit assets	22	**1,020**	865
Regulatory assets	3	**498**	311
Deferred charges		**96**	120
Government reimbursement for the 1998 ice storm[a]		**138**	152
Funds in trust for nuclear waste management[b]		**32**	28
		1,784	1,476

a) Representing installments of $6 million per quarter until January 15, 2014, and a final installment of $1 million on April 15, 2014. These installments include interest at the annual rate of 7.2%.

b) On November 15, 2002, the Act Respecting the Long-Term Management of Nuclear Fuel Waste *came into force. This legislation calls for nuclear energy companies that are owners of such waste in Canada to form a waste management organization as a separate legal entity and to set up a trust with a financial institution in order to finance the implementation of the nuclear fuel waste management proposal that will be adopted by the Government of Canada. In order to fulfill the financial responsibilities incumbent on nuclear fuel waste owners, the Corporation deposited an initial amount of $20 million in a trust within 10 days of the date this Act came into force. It is required to deposit an additional $4 million per year in the same trust until the waste management organization determines the amount to be paid by each nuclear plant owner. The Corporation has been making the required payments since 2002. The sums are invested in short-term marketable securities, and interest accumulated on trust assets is returned to the trust.*

Note 14 | Long-Term Debt

Composition and maturities

Debentures, other long-term debt and swaps representing financial liabilities, translated into Canadian dollars at the closing exchange rates in effect at the balance sheet date, are summarized in the following table. These amounts are presented by year of maturity, considering sinking funds.

							2005	2004
	Debt of the Corporation					Subsidiaries and joint ventures	Total	Total
Maturity	Canadian dollars	U.S. dollars	Other currencies	Sinking funds	Total			
2005	–	–	–	–	–	–	–	1,950
2006	1,139	1,716	286	–	3,141	7	**3,148**	3,199
2007	1,179	679	22	(214)	1,666	3	**1,669**	1,987
2008	86	33	1,167	–	1,286	3	**1,289**	1,517
2009	1,998	35	6	(224)	1,815	54	**1,869**	575
2010	694	30	–	(62)	662	22	**684**	–
1 to 5 years	5,096	2,493	1,481	(500)	8,570	89	**8,659**	9,228
6 to 10 years	3,030	2,578	557	(148)	6,017	46	**6,063**	6,479
11 to 15 years	1,907	484	96	(91)	2,396	–	**2,396**	1,375
16 to 20 years	3,057	2,583	–	(91)	5,549	–	**5,549**	7,183
21 to 25 years	67	3,397	–	(173)	3,291	–	**3,291**	2,066
26 to 30 years	5,704	55	–	(56)	5,703	–	**5,703**	2,386
31 to 35 years	1,776	–	–	(11)	1,765	–	**1,765**	4,562
36 to 40 years	12	–	–	–	12	–	**12**	285
41 to 45 years	70	–	–	–	70	–	**70**	12
46 to 50 years	28	–	–	–	28	–	**28**	82
51 to 55 years	479	–	–	–	479	–	**479**	–
56 to 60 years	412	–	–	–	412	–	**412**	859
	21,638[a]	11,590	2,134	(1,070)[b]	34,292[c]	135	**34,427**	34,517
Less								
Current portion	1,139	1,716	286	–	3,141	7	**3,148**	1,950
	20,499	9,874	1,848	(1,070)	31,151	128	**31,279**	32,567

a) Includes $173 million and $378 million in zero-coupon bonds, reported at their discounted value at a semiannually computed interest rate of 10.95% and 10.67%, respectively. Their par value will reach $282 million and $1,729 million in 2010 and 2020, respectively. Other bonds, reported at their discounted value and amounting to $1,223 million, will reach a par value of $1,333 million at maturity.

b) The sinking funds include a special fund created for the majority of the significant discounted debt. This fund totaled $407 million as at December 31, 2005 ($425 million as at December 31, 2004).

c) Includes $32,014 million in bonds guaranteed by the Quebec government as at December 31, 2005 ($31,349 million as at December 31, 2004).

Note 14 | Long-Term Debt (continued)

Allocation of debt by currency at time of issuance and impact of swaps and sinking funds

The following table summarizes long-term debt, including the current portion, in Canadian dollars and other currencies. Also shown are the effects of currency swaps and sinking funds allocated to repay debt, which are presented in the balance sheet under Swaps and sinking funds.

				2005	2004
	Long-term debt				
	In Canadian dollars and other currencies	At closing exchange rates as at the balance sheet date[a]	Swaps and sinking funds	Total	Total
Debt of the Corporation					
Canadian dollars	20,975	20,975	–	**20,975**	19,073
U.S. dollars	8,456	11,183	(2,373)	**8,810**	10,295
Other currencies					
Euros	673	1,155	(48)	**1,107**	1,107
Yen	25,600	337	(1)	**336**	477
Pounds sterling	240	546	(12)	**534**	534
Swiss francs	97	96	–	**96**	96
		2,134	(61)	**2,073**	2,214
		34,292	(2,434)	**31,858**	31,582
Subsidiaries and joint ventures[b]		135	–	**135**	1,221
		34,427	(2,434)	**31,993**	32,803

a) Includes $1,797 million in financial liabilities composed of currency swaps ($1,460 million as at December 31, 2004) and $1,070 million in Hydro-Québec securities held in sinking funds ($1,042 million as at December 31, 2004).

b) Long-term debt composed of $135 million in U.S. dollars ($893 million in U.S. dollars and $328 million in Unidades de Fomento as at December 31, 2004).

Allocation of debt by currency at time of issuance and at time of repayment

The following table shows the allocation of debt, net of sinking funds, converted into Canadian dollars after taking swaps into account, according to the currency at time of issue and time of repayment.

	2005		2004	
	At time of issuance	At time of repayment	At time of issuance	At time of repayment
Debt of the Corporation				
Canadian dollars	**20,975**	**26,201**	19,073	23,208
U.S. dollars	**8,810**	**5,657**[a]	10,295	8,374[a]
Other currencies	**2,073**	–	2,214	–
	31,858	**31,858**	31,582	31,582
Debt of subsidiaries and joint ventures				
U.S. dollars	**135**	**135**	893	499
Other currencies	–	–	328	722
	135	**135**	1,221	1,221
	31,993	**31,993**	32,803	32,803

a) Of this amount, 89.8% was used to hedge sales in U.S. dollars as at December 31, 2005 (73.1% as at December 31, 2004).

Interest rates

Hydro-Québec's interest rates presented in the following table take into account nominal interest rates on borrowings, the related discounts and borrowing costs, and the effect of interest rate swaps.

%				2005	2004
Maturity	Canadian dollars	U.S. dollars	Other currencies	Weighted average	Weighted average
1 to 5 years	4.67	5.98	4.40	**5.06**	5.87
6 to 10 years	8.56	7.71	11.65	**8.58**	7.96
11 to 15 years	10.71	8.32	6.40	**10.21**	8.33
16 to 20 years	10.25	8.82	–	**9.61**	10.09
21 to 25 years	6.00	8.79	–	**8.72**	8.46
26 to 30 years	6.11	–	–	**6.11**	7.77
31 to 35 years	5.36	–	–	**5.36**	5.99
36 to 40 years	6.52	–	–	**6.52**	6.41
41 to 45 years	6.44	–	–	**6.44**	–
46 to 50 years	–	–	–	–	6.44
51 to 55 years	6.62	–	–	**6.62**	–
56 to 60 years	–	–	–	–	6.62
Weighted average	7.30	8.73	8.40	**7.76**	7.97

The variable-rate portion of Hydro-Québec's debt amounted to 19.0%, or 20.0% after perpetual debt, as at December 31, 2005 (25.0%, or 25.9% after perpetual debt, as at December 31, 2004). For information purposes, a 1% change in interest rates would change consolidated net income by $62 million ($85 million in 2004), not including the impact of derivative instruments used to manage short-term financial risk (Note 18).

Fair value

As at December 31, 2005, the fair value of Hydro-Québec's debt amounted to $44,977 million ($44,024 million as at December 31, 2004). Net of sinking funds and after swaps, it totaled $43,715 million ($42,504 million as at December 31, 2004).

Fair value is obtained by discounting future cash flows, based on forward and closing interest rates as at the balance sheet date for similar instruments available on financial markets. Changes in fair value reflect sensitivity to market interest rates. However, Management intends to hold these debt securities until maturity. Therefore, as at December 31, 2005, Hydro-Québec did not foresee any significant debt repayments that could result in the realization of this fair value.

Hydro-Québec has undrawn revolving standby credit facilities, of which US$1,500 million expires in 2010. Any borrowing under these lines of credit will bear interest at a rate based on the London Interbank Offered Rate (LIBOR).

Note 15 | Asset Retirement Obligations

Liabilities arising from asset retirement obligations relate to the cost of dismantling Gentilly-2 nuclear generating station at the end of its useful life, the removal of irradiated nuclear fuel resulting from its operation and the dismantling of oil tanks and of certain thermal generating stations.

Hydro-Québec has also identified asset retirement obligations relating to thermal generating stations, power transmission lines and substations for which no liability has been recorded since it expects to use these assets for an undetermined period. These relate to property, plant and equipment for which the Corporation does not have sufficient information to accurately establish a maturity schedule for the obligation. A liability stemming from these asset retirement obligations will be accounted for in the period in which there is sufficient information to establish such a schedule.

The aggregate carrying value of asset retirement obligations is as follows:

				2005
	Dismantling of nuclear generating station	Removal of irradiated fuel	Dismantling of other assets	Total
Balance at beginning of year	162	82	20	**264**
Liabilities incurred	–	1	–	**1**
Accretion expense	10	9	1	**20**
Liabilities settled	–	–	(3)	**(3)**
Balance at end of year	172	92	18	**282**

				2004
	Dismantling of nuclear generating station	Removal of irradiated fuel	Dismantling of other assets	Total
Balance at beginning of year	140	72	22	234
Liabilities incurred	13	3	1	17
Accretion expense	9	7	1	17
Liabilities settled	–	–	(4)	(4)
Balance at end of year	162	82	20	264

Note 15 Asset Retirement Obligations (continued)

The carrying value of asset retirement obligations is based on the following key assumptions:

	Dismantling of nuclear generating station	Removal of irradiated fuel	Dismantling of other assets
Total undiscounted amount of estimated cash flows required to settle the obligations (in current dollars)	463[a]	519[a]	21
Expected timing of payment of the cash flows required to settle the obligations	Between 2012 and 2050[a]	Between 2012 and 2047[a]	Between 2006 and 2031
Credit-adjusted risk-free rate at which the estimated cash flows have been discounted (%)	6.4	6.4	6.4

a) When Gentilly-2 nuclear generating station was designed, the Corporation planned to operate it for 30 years, until 2013. The Corporation initiated a draft-design study to evaluate whether its useful life could be extended by 25 years through refurbishment. If the refurbishment is not carried out, Management could decide to decommission the nuclear generating station a few years earlier, depending on technical and economic factors. Pending the decision, the consolidated financial statements reflect end-of-life in 2011 for purposes of calculating the depreciation of the station and the related decommissioning costs. Consequently, once the decision is made, the estimated undiscounted cash flows and the expected timing of payment of the cash flows required to settle the obligations could change and thus, asset retirement obligations and decommissioning costs as well as the depreciation expense and accretion expense, as recorded in these consolidated financial statements, may vary significantly based on the end-of-life date retained and the increase inherent in the method used to calculate depreciation and amortization. As at December 31, 2005, the net carrying value of Gentilly-2 was $623 million ($692 million as at December 31, 2004). Based on the key assumptions established, asset retirement obligations relating to the dismantling of the nuclear generating station and the removal of irradiated fuel will total $911 million and $1,122 million, respectively, after factoring in a 2% inflation rate. However, the remaining portions of these obligations are scheduled to extend over periods of 45 years and 42 years, respectively.

Note 16 Other Long-Term Liabilities

	Note	2005	2004
Deferred foreign exchange gain		**1,454**	1,272
Accrued benefit liability	22	**497**	452
Accounts payable		**126**	259
Discounts and other deferred credits related to long-term debt		**322**	205
Credit risk management		**149**	173
		2,548	2,361

Note 17 Perpetual Debt

Perpetual notes in the amount of US$325 million (US$325 million as at December 31, 2004) bear interest at a rate established semi-annually based on LIBOR. They are guaranteed by the Québec government and are redeemable only at the Corporation's option. No portion was redeemed in 2005. In 2004, a portion amounting to US$15 million was repurchased on the secondary market and then canceled. Various derivative instruments recorded at fair value are used to mitigate exchange risk.

As at December 31, 2005, the fair value of these notes was $383 million ($370 million as at December 31, 2004). As at December 31, 2005, and December 31, 2004, LIBOR for perpetual notes was 4.2% and 2.1%, respectively.

Note 18 Financial Instruments

Derivative instruments

Hydro-Québec engages in currency swaps and forward contracts in order to manage the foreign exchange risk associated with repayments of principal on long-term debt, interest payments and sales in U.S. dollars. Some of these currency swaps allow for interest rate exchanges in order to modify interest rate risk exposure over the long term. Interest rate swaps that do not allow for exchanges of principal are also used to manage this risk.

The valuation of these swaps and forward contracts, with terms to maturity through 2033, indicated a positive fair value of $8 million (positive fair value of $167 million as at December 31, 2004).

The following table presents the notional amounts of these swaps, expressed in Canadian dollars and other currencies.

						2005[a]	2004[a]
Maturity	1 to 5 years	6 to 10 years	11 to 15 years	16 to 20 years	More than 20 years	Total	Total
Swaps							
Canadian dollars	630	(476)	25	(2,019)	(3,386)	**(5,226)**	(4,136)
U.S. dollars	(616)	11	(31)	1,640	2,613	**3,617**	2,191
Other currencies							
Yen	23,600	1,000	1,000	–	–	**25,600**	36,500
Euros	612	–	61	–	–	**673**	673
Pounds sterling	–	240	–	–	–	**240**	240
Swiss francs	97	–	–	–	–	**97**	97
Unidades de Fomento (indexed Chilean pesos)	–	–	–	–	–	–	(11)
Forward contracts							
U.S. dollars	477	–	–	–	–	**477**	1,774

a) Figures in parentheses represent amounts to be paid.

In managing short-term financial risks, Hydro-Québec assesses, on an ongoing basis, the overall impact of variations in exchange rates, interest rates and commodity prices. In order to manage its currency risk exposure, it transacted options and currency futures for a cumulative amount of $731 million, of which $389 million was in the form of forward purchase contracts and $342 million in the form of forward sales contracts ($1,588 million in 2004, of which $1,161 million was in purchase contracts and $427 million in sales contracts). To manage interest rate fluctuations, it engaged in options, swaps and forward rate agreements. For information purposes, a 1% variance in interest rates would result in a $55-million variance in net income ($50 million in 2004). Finally, Hydro-Québec transacted options, swaps and forward contracts totaling 136,500 tonnes of aluminum (292,275 tonnes of aluminum in 2004) to manage the risk of fluctuations in commodity prices.

Hydro-Québec also uses derivative instruments to manage market risks resulting from fluctuations in energy prices, and for trading purposes in order to act on business opportunities in markets outside Québec. It transacted electricity swaps for 0.3 TWh (1.3 TWh in 2004) to hedge this risk.

The fair value of these instruments is presented by specific risk in the following table. Of these fair values, ($99 million) will mature in 2006 and $20 million will mature in 2007.

	2005		2004	
	Carrying value	Fair value	Carrying value	Fair value
Exchange risk				
Forward exchange contracts and options				
Financial assets	–	**8**	15	47
Financial liabilities	–	**(43)**	(22)	(101)
	–	**(35)**	(7)	(54)
Interest rate risk				
Forward rate agreements, options and swaps				
Financial assets	**24**	**39**	5	2
Financial liabilities	**(3)**	**(4)**	(10)	(15)
	21	**35**	(5)	(13)
Risk of changes in energy and commodity prices				
Forward contracts, options and swaps				
Financial assets	**16**	**16**	12	12
Financial liabilities	**(2)**	**(95)**	(11)	(107)
	14	**(79)**	1	(95)
	35	**(79)**	(11)	(162)

Other financial instruments

The carrying amount of investments, accounts receivable, the government reimbursement for the 1998 ice storm, the trust fund for nuclear fuel waste management, short-term borrowings, accounts payable and accrued liabilities, dividends payable and accrued interest approximates their fair value. As at December 31, 2005, the weighted average interest rate on short-term investments was 3.26% (2.26% as at December 31, 2004), whereas it was 2.81% (3.16% as at December 31, 2004) on short-term borrowings.

Credit risk

Derivative instruments include an element of risk since a counterparty might not meet its obligations. However, this risk is moderate as Hydro-Québec generally deals with Canadian and international financial institutions with high credit ratings. Credit risk exposure is also reduced by applying a credit policy limiting credit risk concentration and a counterparty credit risk assessment program, as well as by adopting credit limits, where necessary. As at December 31, 2005, no counterparty had defaulted on its obligations toward Hydro-Québec regarding investments and derivatives.

Hydro-Québec is also exposed to credit risk associated with trade receivables. However, this exposure is limited due to Hydro-Québec's large and diverse customer base. Consequently, Management does not consider Hydro-Québec to be exposed to a material credit risk.

Note 19 Interests in Joint Ventures

The proportionate share of the joint venture items included in the consolidated financial statements is presented in the table below. These joint ventures include the interests managed by the Hydro-Québec Technologie et développement industriel and Hydro-Québec Production divisions, as well as interests in various foreign joint ventures, primarily through Hydro-Québec International.

	2005	2004
Operations		
Revenue	**33**	21
Expenditure and financial expenses	**130**	59
Discontinued operations	**10**	46
Net (loss) income	**(87)**	8
Balance sheets		
Current assets	**56**	44
Long-term assets	**295**	383
Current liabilities	**56**	43
Long-term liabilities	**114**	87
Non-controlling interest	**–**	27
Net assets	**181**	270
Cash flows		
Operating activities	**(35)**	(45)
Investing activities	**(4)**	(8)
Financing activities	**36**	31
Discontinued operations	**9**	(15)
Net change in cash and cash equivalents	**6**	(37)

Note 20 Shareholder's Equity

The authorized share capital consists of 50,000,000 shares with a par value of $100 each, of which 43,741,090 shares were issued and paid-up.

Under the *Hydro-Québec Act*, the dividends to be paid by the Corporation are declared once a year by the Québec government, which also determines the terms and conditions of payment. For a given fiscal year, they cannot exceed the distributable surplus, equal to 75% of the year's operating income and net investment income, less interest on debt securities and amortization of discounts and borrowing expenses. This calculation is performed using the consolidated financial statements.

However, in respect of a given fiscal year, no dividend may be declared in an amount that would have the effect of reducing the capitalization rate to less than 25% at the end of the year. The Québec government declares the dividends for a given year within 30 days after the Corporation has sent it the financial data related to the distributable surplus. Upon expiry of the prescribed period, any portion of the distributable surplus that has not been subject to a dividend declaration may no longer be distributed to the shareholder as a dividend.

For 2005, the Québec government declared dividends of $1,126 million ($1,350 million in 2004), which is less than the maximum permitted.

The dividends declared are deducted from the retained earnings of the year for which they were declared.

Note 21 Supplementary Cash Flow Information

	2005	2004
Change in non-cash working capital items		
Accounts receivable	**35**	(176)
Materials, fuel and supplies	**(24)**	(9)
Accounts payable and accrued liabilities	**273**	183
Accrued interest	**(16)**	6
	268	4
Investing activities not affecting cash		
Increase in property, plant and equipment and intangible assets	**28**	366
Cash and cash equivalents paid during the year		
Interest paid	**2,245**	2,268

Note 22 Employee Future Benefits

The Corporation's pension plan (the "Pension Plan") is a funded plan that ensures pension benefits based on the number of years of service and an average of the five best years of earnings. These benefits are indexed annually based on a rate which is the greater of the inflation rate, up to a maximum of 2%, and the inflation rate less 3%.

The Corporation also offers other post-retirement and post-employment benefits. Post-retirement benefits are provided by group life, medical and hospitalization plans, which are contributory plans with contributions adjusted annually. Post-employment benefits are under non-contributory salary insurance plans, which pay short- and long-term disability benefits. Most of these plans are not funded, with the exception of the long-term disability salary insurance plan, which is fully funded, and the supplementary group life insurance plan, which is partially funded.

The Corporation's employee benefit plans are defined benefit plans. Accrued benefit obligations of these plans, valued by independent actuaries, and assets, at fair value, are valued as at December 31 of each year. The most recent actuarial valuation for purposes of Pension Plan funding was as at December 30, 2004, and the next valuation should be performed no later than December 30, 2007.

The following tables present information concerning the Corporation's employee future benefits plans:

	Pension Plan		Other plans	
	2005	2004	2005	2004
Accrued benefit obligations				
Balance at beginning of year	**10,256**	8,628	**688**	591
Current service cost	**331**	288	**31**	26
Benefit payments and refunds	**(387)**	(353)	**(39)**	(37)
Interest on obligations	**616**	568	**42**	39
Actuarial losses	**1,109**	1,125	**115**	69
Balance at end of year	**11,925**	10,256	**837**	688
Plan assets at fair value				
Balance at beginning of year	**9,982**	9,217	**49**	49
Actual return on plan assets	**1,387**	1,088	**2**	2
Employee contributions	**38**	38	**–**	–
Current contributions by the Corporation	**307**	25	**9**	5
Special contribution by the Corporation	**34**	–	**–**	–
Benefit payments and refunds	**(387)**	(353)	**(9)**	(7)
Administrative fees	**(30)**	(33)	**–**	–
Balance at end of year	**11,331**	9,982	**51**	49
Deficit at end of year	**(594)**	(274)	**(786)**	(639)
Unamortized past service costs	**295**	339	**–**	–
Unamortized net actuarial loss	**2,536**	2,169	**181**	65
Unamortized transitional (asset) obligation	**(1,217)**	(1,369)	**108**	122
Accrued benefit asset (liability)	**1,020**	865	**(497)**	(452)

Additional disclosures with respect to plan assets

At year end, assets of the Pension Plan at fair value consisted of:

%	2005	2004
Equities	**55**	55
Bonds	**31**	31
Real estate investments	**5**	5
Other	**9**	9
	100	100

Plan assets include securities issued by the Corporation and certain related companies. These securities are grouped under the following asset classes:

	2005	2004
Pension Plan		
Bonds	**763**	656
Short-term investments	**–**	1
	763	657
Other plans		
Bonds	**32**	32
Short-term investments	**14**	11
	46	43

Cash payments

Cash payments made by the Corporation for employee benefit plans consist of the contributions paid to funded plans and benefits paid to employees and pensioners under unfunded plans. The cash payment details are as follows:

	2005	2004
Contributions by the Corporation		
Pension Plan	**341**	25
Other funded plans	**9**	5
Benefit payments – unfunded plans	**32**	30
Cash payments	**382**	60

The Corporation and its employees resumed their contributions to the Pension Plan on December 15, 2003. The employee and employer contribution rates are increasing by 1% and 1.8%, respectively, each year to reach a maximum of 5.2% of pensionable earnings. In 2005, contributions amounted to 2% of pensionable earnings for employees and 3.6% for the Corporation (1% and 1.8%, respectively, in 2004). Moreover, after the actuarial valuation for funding purposes dated December 30, 2004, was submitted to the Régie des rentes du Québec, the Corporation made an additional contribution of $254 million in 2005 to cover current service costs and a special contribution of $34 million to cover the actuarial deficit.

Note 22 | Employee Future Benefits (continued)

Elements of accrued benefit cost recognized in the year

	Pension Plan		Other plans	
	2005	2004	**2005**	2004
Current service cost,[a] net of employee contributions	**293**	227	**31**	26
Administrative fees[b]	**30**	33	**–**	–
Interest on obligations	**616**	568	**42**	39
Actual return on plan assets	**(1,387)**	(1,088)	**(2)**	(2)
Actuarial losses	**1,109**	1,125	**115**	69
Cost before adjustments required to recognize the long-term nature of employee future benefits	**661**	865	**186**	132
Difference between actual and expected return on assets	**703**	364	**–**	–
Difference between actuarial losses on accrued benefit obligations and actuarial losses recognized	**(1,070)**	(1,125)	**(114)**	(71)
Difference between adjustments for plan amendments and amortization of past service costs	**44**	52	**–**	–
Amortization of transitional (asset) obligation	**(152)**	(152)	**14**	14
	(475)	(861)	**(100)**	(57)
Cost recognized in the year	**186**	4	**86**	75

a) For the long-term disability salary insurance plan, current service cost corresponds to the cost of new disability cases for the year.

b) Administrative fees chargeable to the Pension Plan are fully billed by the Corporation.

Significant actuarial assumptions

The following actuarial assumptions, used to determine the accrued benefit obligations and cost of the plans, result from a weighted average.

	Pension Plan		Other plans	
%	**2005**	2004	**2005**	2004
Accrued benefit obligations				
Rate at end of year				
Discount rate	**5.30**	6.03	**5.30**	6.03
Salary escalation rate[a]	**3.89**	3.87	**–**	–
Accrued benefit cost recognized				
Rate at end of prior year				
Discount rate	**6.03**	6.67	**6.03**	6.67
Expected long-term rate of return on plan assets	**6.52**	6.86	**3.68**	3.53
Salary escalation rate[a]	**3.87**	3.41	**–**	–

a) This rate takes into account salary increases and promotion opportunities while in service.

As at December 31, 2005, healthcare costs were based on an annual growth rate of 8.60% in 2006. Thereafter, based on the assumption used, this rate will gradually decrease until it ultimately reaches 4.30% in 2016. A 1% change in this annual growth rate would have the following impact on operations for 2005:

	1% increase	1% decrease
Impact on current service cost and interest cost on accrued benefit obligations for the year	5	(4)
Impact on accrued benefit obligations at end of year	53	(43)

Note 23 Commitments and Contingencies

Electricity purchases

On May 12, 1969, the Corporation signed a contract with Churchill Falls (Labrador) Corporation Limited (CF(L)Co) whereby the Corporation undertook to purchase substantially all the output from Churchill Falls generating station, which has a rated capacity of 5,428 MW. Expiring in 2016, this contract will be automatically renewed for a further 25 years under agreed-upon terms and conditions. On June 18, 1999, the Corporation and CF(L)Co entered into a contract to guarantee the availability of 682 MW of additional power until 2041 for the November 1 to March 31 winter period.

As at December 31, 2005, the Corporation was committed under 98 contracts to purchase electricity from other power producers, for an installed capacity of about 3,697 MW. It expects to purchase approximately 13 TWh of energy annually over the initial terms of these contracts, which extend through 2033. The majority of these contracts include renewal clauses.

The Corporation expects to make the following payments on its electricity purchase contracts over the next five years:

2006	732
2007	1,116
2008	1,130
2009	1,159
2010	1,231

Guarantees

Hydro-Québec grants guarantees to third parties for indemnification purposes in connection with its energy-related transactions on markets outside Québec. These guarantees are issued under long-term agreements and agreements governing its involvement in organized markets. These markets require that each participant provide guarantees enabling it to meet its obligations in the event of a payment default by another participant. Hydro-Québec also grants guarantees as part of its international operations and in the field of electrotechnology.

As at December 31, 2005, the potential maximum amount that Hydro-Québec could have had to pay under letters of credit or guarantees totaled $419 million. Of this amount, $319 million relates to the purchase of energy, and a liability in the amount of $25 million has been recorded accordingly. Some guarantees expire between 2006 and 2019, while others do not have maturity dates.

In accordance with the terms and conditions of bond issues made outside Canada, the Corporation has a commitment to increase the amount of interest paid to non-residents in the event of changes to Canadian tax legislation governing the taxation of non-residents' income. The Corporation cannot estimate the maximum amount it might have to pay under such circumstances. Should an amount become payable, the Corporation has the option of redeeming the bonds in question.

Under the agreement with CF(L)Co, the Corporation could be required to provide additional funding if CF(L)Co were unable to pay its expenses and service its debt. The maximum amount that the Corporation could be required to pay cannot be reasonably evaluated, however, since it is not stated in the agreement and since the amount payable would depend on the outcome of future events whose nature and probability cannot be determined. To date, the Corporation has not had to pay any amount under this agreement.

In 2004, Hydro-Québec provided guarantees to the purchaser of its interest in Noverco Inc. concerning all its representations in the sales agreement for a two-year period ending on June 30, 2006, for which no liability was recorded. It further guarantees additional tax liabilities until the expiry of a 60-day period after the date on which the authorities will no longer be authorized to determine the tax assessment.

Investments

The Corporation expects to invest approximately $4 billion in property, plant and equipment and intangible assets in 2006.

Agreements entered into with Aboriginal communities and regional county municipalities

Hydro-Québec has entered into various agreements related to capital projects and intangible assets with Aboriginal communities and regional county municipalities. The commitments under these agreements are recorded under Long-term debt when they meet the definition of a liability, and the consideration is accounted for under Property, plant and equipment and Intangible assets.

Litigation

In the normal course of business, Hydro-Québec is sometimes party to claims and legal proceedings. Management is of the opinion that adequate provisions have been made for any disbursements that could result from these legal actions. Consequently, it does not foresee any adverse effect of such contingent liabilities on Hydro-Québec's consolidated operating results or financial position.

Note 24 Related Party Transactions

Hydro-Québec enters into various business transactions with the Québec government and its organizations, as well as with other government corporations in the normal course of business. These transactions are measured at the exchange amount.

Other transactions with the Québec government are described elsewhere in the consolidated financial statements.

Note 25 Segmented Information

Hydro-Québec carries on its activities in the four reportable segments defined below. The non-reportable segments and other activities are grouped together under Corporate and Other Activities for reporting purposes. In 2005, the activities of Hydro-Québec International and of Hydro-Québec Pétrole et gaz were grouped under Corporate and Other Activities, and the corresponding information for the preceding year was reclassified accordingly.

Generation: Hydro-Québec Production operates and develops the Corporation's generating facilities. This division also sells electricity on external markets and engages in energy trading. Hydro-Québec Production provides Hydro-Québec Distribution with a base volume of up to 165 TWh of heritage pool electricity annually at an average price of 2.79¢/kWh. In excess of this volume, it can participate in Hydro-Québec Distribution's calls for tenders in a context of free market competition.

Transmission: Hydro-Québec TransÉnergie develops and operates the Corporation's electric power transmission system in Québec and the related telecommunications system.

Distribution: Hydro-Québec Distribution operates and develops the Corporation's distribution system and is responsible for sales and services to Québec customers. It also ensures the security of the supply of electricity to the Québec market.

Note 25 | Segmented Information (continued)

Construction: Hydro-Québec Équipement carries out engineering and construction work related to hydroelectric development projects throughout Québec, except on the territory governed by the *James Bay and Northern Québec Agreement*, where Société d'énergie de la Baie James assumes this responsibility. Hydro-Québec Équipement also carries out projects for the construction of power transmission lines and substations throughout Québec.

Corporate and Other Activities: This heading includes corporate activities, mainly financial services, human resources, corporate affairs, and the activities of the Shared Services Centre (such as procurement, computer services and corporate telecommunications). It also covers the activities managed by Hydro-Québec Technologie et développement industriel, that is, research, technical support, industrial development of Hydro-Québec technologies, and capital venturing. The activities of Hydro-Québec International and of Hydro-Québec Pétrole et gaz are also included.

The amounts presented for each segment are based on the financial information used to establish the consolidated financial statements. The accounting policies used to calculate these amounts are as described in notes 1 and 3.

Intersegment transactions related to electricity sales are recorded based on the supply and transmission rates provided for by the *Act respecting the Régie de l'énergie*. The Act sets a commodity rate for a base volume of up to 165 TWh of heritage pool electricity for the Québec market.

The other intersegment products and services are valued at full cost.

The following tables contain information related to operations and assets by segment as well as geographic information:

Segments

							2005
	Generation	Transmission	Distribution	Construction	Corporate and Other Activities	Intersegment eliminations	Total
Revenue							
External customers	1,708	28	9,181	6	16	(49)	**10,890**
Intersegment	4,532	2,550	55	2,053	921	(10,111)	**–**
Depreciation and amortization	880	575	489	5	91	–	**2,040**
Financial expenses	1,050	727	384	–	52	1	**2,214**
Income (loss) from continuing operations	1,873	369	172	5	(162)	(8)	**2,249**
Discontinued operations	–	–	58	–	(55)	–	**3**
Net income (loss)	1,873	369	230	5	(217)	(8)	**2,252**
Investments in property, plant and equipment and intangible assets							
Affecting cash	1,780	793	645	6	58	–	**3,282**
Not affecting cash	8	12	8	–	–	–	**28**
Total assets	27,482	16,329	10,556	242	6,055	(232)	**60,432**

Segments

							2004
	Generation	Transmission	Distribution	Construction	Corporate and Other Activities	Intersegment eliminations	Total
Revenue							
External customers	1,293	18	8,987	9	93	(1)	10,399
Intersegment	4,607	2,529	55	1,960	890	(10,041)	–
Depreciation and amortization	723	587	447	5	108	–	1,870
Financial expenses	1,016	679	345	–	70	1	2,111
Income (loss) from continuing operations	1,661	409	275	4	(171)	(53)	2,125
Discontinued operations	–	–	12	–	298	–	310
Net income (loss)	1,661	409	287	4	127	(53)	2,435
Investments in property, plant and equipment and intangible assets							
Affecting cash	1,820	586	601	12	53	–	3,072
Not affecting cash	350	10	6	–	–	–	366
Total assets	26,469	16,056	10,279	246	5,295	(227)	58,118

Geographic information

		2005		2004
	Revenue	Property, plant and equipment, intangible assets and goodwill	Revenue	Property, plant and equipment, intangible assets and goodwill
Québec	**9,178**	**50,986**	9,032	49,827
Canada, outside Québec	**259**	**25**	127	22
United States	**1,387**	**37**	1,158	230
Chile	**–**	**–**	2	1,685
Other countries	**66**	**189**	80	472
	10,890	**51,237**	10,399	52,236

Note 25 | Segmented Information (continued)

Construction: Hydro-Québec Équipement carries out engineering and construction work related to hydroelectric development projects throughout Québec, except on the territory governed by the *James Bay and Northern Québec Agreement*, where Société d'énergie de la Baie James assumes this responsibility. Hydro-Québec Équipement also carries out projects for the construction of power transmission lines and substations throughout Québec.

Corporate and Other Activities: This heading includes corporate activities, mainly financial services, human resources, corporate affairs, and the activities of the Shared Services Centre (such as procurement, computer services and corporate telecommunications). It also covers the activities managed by Hydro-Québec Technologie et développement industriel, that is, research, technical support, industrial development of Hydro-Québec technologies, and capital venturing. The activities of Hydro-Québec International and of Hydro-Québec Pétrole et gaz are also included.

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	10,890	**51,237**	10,399	52,236

Consolidated Financial Information

$M	2005	2004	2003	2002	2001
OPERATIONS					
Revenue	**10,890**	10,399	10,258	11,905	11,251
Expenditure					
Operations	**2,294**	2,216	2,126	2,083	2,005
Electricity and fuel purchases	**1,485**	1,465	1,381	3,023	2,777
Depreciation and amortization	**2,040**	1,870	1,775	1,858	1,710
Taxes	**602**	609	570	540	552
	6,421	6,160	5,852	7,504	7,044
Operating income	**4,469**	4,239	4,406	4,401	4,207
Financial expenses	**2,214**	2,111	2,529	2,806	3,687
Income from continuing operations before non-controlling interest	**2,255**	2,128	1,877	1,595	520
Non-controlling interest	**6**	3	2	4	3
Income from continuing operations	**2,249**	2,125	1,875	1,591	517
Discontinued operations	**3**	310	63	(6)	74
Net income	**2,252**	2,435	1,938	1,585	591*
SUMMARY OF BALANCE SHEETS					
Total assets	**60,432**	58,118	57,823	59,247	58,812
Long-term debt	**31,279**	32,567	34,402	36,754	37,313
Shareholder's equity	**17,376**	16,220	15,128	14,208	13,473
ANNUAL INVESTMENTS FOR CONTINUING OPERATIONS AFFECTING CASH					
Property, plant and equipment and intangible assets	**3,282**	3,072	2,740	2,239	1,740
Other	**161**	(943)	(43)	1	(10)
Total investments	**3,443**	2,129	2,697	2,240	1,730
FINANCIAL RATIOS					
Interest coverage[a]	**1.95**	1.77	1.70	1.61	1.44
Capitalization (%)[b]	**34.2**	32.8	29.8	26.2	24.8
Self-financing (%)[c]	**56.9**	75.3	57.3	72.8	50.6
Return on equity (%)[d]	**13.4**	15.5	13.2	11.5	4.4*
Return on revenue from continuing operations (%)[e]	**20.7**	20.4	18.3	13.4	4.6*

* *Had not for the adjustments related to the retroactive application of the accounting standard governing foreign currency translation, the data presented would show net income of $1,108 million, a return on equity of 7.6% and a return on revenue from continuing operations of 9.2%.*

a) Sum of operating income and net investment income divided by gross interest expense.

b) Shareholder's equity divided by the sum of shareholder's equity, long-term debt, perpetual debt, short-term borrowings and current portion of long-term debt, less swaps and sinking funds.

c) Cash from continuing operations less dividends paid, divided by the sum of investments, long-term debt maturities and sinking fund redemptions.

d) Net income divided by average shareholder's equity.

e) Net income from continuing operations divided by revenue.

Note: Throughout the Five-Year Review and Consolidated Results by Quarter, certain figures for previous years have been reclassified to reflect the presentation of the current year.

Operating Statistics

	2005	2004	2003	2002	2001
GWh					
Electricity sales					
In Québec					
Residential and farm	**57,024**	58,002	57,217	53,231	50,850
General and institutional	**33,639**	33,137	32,314	31,695	30,360
Industrial	**73,516**	69,722	72,546	68,535	66,343
Other	**4,998**	5,026	5,014	5,111	4,659
	169,177	165,887	167,091	158,572	152,212
Outside Québec					
Canada/U.S. (long-term)	**2,068**	1,930	2,047	2,219	3,691
Canada/U.S. (short-term)	**13,274**	12,462	13,739	51,980	38,698
	15,342	14,392	15,786	54,199	42,389
Total electricity sales	**184,519**	180,279	182,877	212,771	194,601
$M					
Revenue from electricity sales					
In Québec					
Residential and farm	**3,675**	3,690	3,504	3,246	3,131
General and institutional	**2,295**	2,234	2,096	2,058	1,973
Industrial	**2,896**	2,751	2,742	2,577	2,482
Other	**255**	247	236	231	217
	9,121	8,922	8,578	8,112	7,803
Outside Québec					
Canada/U.S. (long-term)	**174**	179	207	233	288
Canada/U.S. (short-term)	**1,290**	905	1,138	3,233	2,794
	1,464	1,084	1,345	3,466	3,082
Total revenue from electricity sales	**10,585**	10,006	9,923	11,578	10,885
As at December 31					
Number of customer accounts in Québec					
Residential and farm	**3,450,455**	3,399,776	3,343,271	3,295,544	3,257,361
General and institutional	**283,616**	282,748	281,997	281,696	280,796
Industrial	**12,796**	13,117	13,383	13,509	13,215
Other	**5,643**	5,634	5,812	5,793	5,919
Total customer accounts	**3,752,510**	3,701,275	3,644,463	3,596,542	3,557,291
kWh/customer account					
Average annual consumption in Québec					
Residential and farm	**16,649**	17,203	17,237	16,247	15,680
General and institutional	**118,789**	117,352	114,651	112,695	108,061
Industrial	**5,674,063**	5,262,038	5,395,359	5,129,097	5,045,862
Other	**886,406**	878,211	864,110	872,780	785,666

Consolidated Financial Information

$M	2005	2004	2003	2002	2001
OPERATIONS					
Revenue	**10,890**	10,399	10,258	11,905	11,251
Expenditure					
Operations	**2,294**	2,216	2,126	2,083	2,005
Electricity and fuel purchases	**1,485**	1,465	1,381	3,023	2,777
Depreciation and amortization	**2,040**	1,870	1,775	1,858	1,710
Taxes	**602**	609	570	540	552
	6,421	6,160	5,852	7,504	7,044
Operating income	**4,469**	4,239	4,406	4,401	4,207
Financial expenses	**2,214**	2,111	2,529	2,806	3,687
Income from continuing operations before non-controlling interest	**2,255**	2,128	1,877	1,595	520
Non-controlling interest	**6**	3	2	4	3
Income from continuing operations	**2,249**	2,125	1,875	1,591	517
Discontinued operations	**3**	310	63	(6)	74
Net income	**2,252**	2,435	1,938	1,585	591*
SUMMARY OF BALANCE SHEETS					
Total assets	**60,432**	58,118	57,823	59,247	58,812
Long-term debt	**31,279**	32,567	34,402	36,754	37,313
Shareholder's equity	**17,376**	16,220	15,128	14,208	13,473
ANNUAL INVESTMENTS FOR CONTINUING OPERATIONS AFFECTING CASH					
Property, plant and equipment and intangible assets	**3,282**	3,072	2,740	2,239	1,740
Other	**161**	(943)	(43)	1	(10)
Total investments	**3,443**	2,129	2,697	2,240	1,730
FINANCIAL RATIOS					
Interest coverage[a]	**1.95**	1.77	1.70	1.61	1.44
Capitalization (%)[b]	**34.2**	32.8	29.8	26.2	24.8
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Other	**886,406**	878,211	864,110	872,780	785,666

Operating Statistics

	2005	2004	2003	2002	2001
MW					
Installed capacity[a]					
Hydroelectric	**32,299**	31,622	31,347	30,392	30,386
Conventional thermal	**1,595**	1,593	1,592	1,592	1,591
Nuclear	**675**	675	675	675	675
Wind	**2**	2	2	2	2
Total installed capacity	**34,571**	33,892	33,616	32,661	32,654
GWh					
Total energy requirements[b]	**200,179**	193,025	194,792	192,916	186,645
MW					
Peak power demand in Québec[c]	**33,636**	34,956	36,268	34,989	30,080
km					
Lines (overhead and underground)					
Transmission	**32,544**	32,487	32,434	32,314	32,273
Distribution[d]	**108,344**	107,423	106,568	105,871	105,352
	140,888	139,910	139,002	138,185	137,625

a) In addition to the installed capacity of its own generating stations, Hydro-Québec has access to most of the output from Churchill Falls, which has a rated capacity of 5,428 MW, and to all of the output from the 196 turbines at five wind farms with a total installed capacity of 210 MW.

b) Total energy requirements consist of kilowatthours delivered within Québec and to neighboring systems.

c) Total power demand at the annual domestic peak for the winter beginning in December, including interruptible power. The 2005–2006 winter peak for Québec occurred at 6 p.m. on February 27, 2006.

d) These figures include off-grid systems but exclude private systems, lines under construction and 44-kV lines (transmission).

Other Information

	2005	2004	2003	2002	2001
%					
Rate increases					
Average increase	**1.3**	4.1	–	–	–
Inflation rate	**2.2**	1.9	2.8	2.2	2.5
Number of employees[a]					
Permanent as at December 31	**19,009**	18,835	18,317	18,025	17,679
Temporary (year's average)	**3,577**	3,567	3,596	3,632	3,545
Women (%)	**29.8**	29.4	28.9	28.5	28.3

a) Excludes employees of subsidiaries and joint ventures.

Consolidated Results by Quarter

$M	1st quarter	2nd quarter	3rd quarter	4th quarter	2005 12-month period
				(unaudited)	(audited)
Revenue	3,136	2,464	2,465	2,825	**10,890**
Expenditure					
Operations	542	593	567	592	**2,294**
Electricity and fuel purchases	332	344	391	418	**1,485**
Depreciation and amortization	483	450	471	636	**2,040**
Taxes	152	115	161	174	**602**
	1,509	1,502	1,590	1,820	**6,421**
Operating income	1,627	962	875	1,005	**4,469**
Financial expenses	585	570	537	522	**2,214**
Income from continuing operations before non-controlling interest	1,042	392	338	483	**2,255**
Non-controlling interest	3	1	1	1	**6**
Income from continuing operations	1,039	391	337	482	**2,249**
Discontinued operations	15	11	54	(77)	**3**
Net income	1,054	402	391	405	**2,252**

$M	1st quarter	2nd quarter	3rd quarter	4th quarter	2004 12-month period
				(unaudited)	(audited)
Revenue	3,028	2,189	2,304	2,878	10,399
Expenditure					
Operations	531	510	517	658	2,216
Electricity and fuel purchases	416	433	312	304	1,465
Depreciation and amortization	437	441	455	537	1,870
Taxes	150	149	152	158	609
	1,534	1,533	1,436	1,657	6,160
Operating income	1,494	656	868	1,221	4,239
Financial expenses	415	563	558	575	2,111
Income from continuing operations before non-controlling interest	1,079	93	310	646	2,128
Non-controlling interest	1	1	1	-	3
Income from continuing operations	1,078	92	309	646	2,125
Discontinued operations	22	283	5	-	310
Net income	1,100	375	314	646	2,435

Operating Statistics

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Discontinued operations	22	283	5	-	310
Net income	1,100	375	314	646	2,435

Thierry Vandal
President and Chief Executive Officer

Marie-José Nadeau
Executive Vice President, Corporate Affairs and Secretary General

Élie Saheb
Executive Vice President, Technology

Daniel Garant
Executive Vice President, Finance and Chief Financial Officer

Maurice Charlebois
Executive Vice President, Human Resources and Shared Services

Board of Directors

Michael L. Turcotte[a, b, c, d, e, f, g, h, i, j, k]
Chairman of the Board,
Hydro-Québec

Normand Bergeron
Deputy Minister of Natural Resources
and Wildlife, Gouvernement du Québec

Joseph Benarrosh[d, f]
President, JJDS Capital inc.

Gaston Blackburn[c, g]
President, G. Blackburn Inc.

Andrée Corriveau[d, j]
President, Extensio Inc.

Bernard Gaudreault[a, k]
Director

Norman E. Hébert Jr.[a, j, k]
President and Chief Executive Officer,
Groupe Park Avenue

Régis Labeaume[a, j]
President and Chief Executive Officer,
Fondation de l'entrepreneurship

Louis Lagassé[a, e, f, k, j]
Chairman and Chief Executive Officer,
Media5 Corporation

Thierry Vandal[a, b, c, d, e, f, g, h, i, j]
President and Chief Executive Officer,
Hydro-Québec

Yvon Lamontagne[a, e, k]
Chairman of the Board,
SCOR Canada Reinsurance Company

Paul Larocque[c, g]
Mayor, Bois-des-Filion

Jacques Leblanc[a, k]
President, Gestion Jacques Leblanc inc.

Michel Noël de Tilly[a, k]
Director

Michel Plessis-Bélair[a, e, f]
Vice-Chairman and Chief Financial Officer,
Power Corporation of Canada

Marie-France Poulin[c, h, j]
Executive Vice President, Groupe Camada inc.

Marie-Anne Tawil
President, Les Investissements Iron Hill Inc.

Board Committees

a Executive Committee
b Distribution
c Environment and Corporate Social Responsibility
d Ethics and Corporate Governance
e Finance
f Pension Plan Financial Management
g Generation
h Human Resources
i Technology
j Transmission
k Audit

Corporate Governance

Hydro-Québec's Board of Directors adopts practices that are in line with the new corporate governance legislation. It follows the guidelines set by the Canadian Securities Administrators to the extent that they apply to a government-owned utility like Hydro-Québec even though, legally speaking, it is not required to do so because it is not a publicly traded company.

Mandate

The Board administers the company's business in accordance with the *Hydro-Québec Act* and its regulations and with the *Companies Act*. Its most important functions are set out in Hydro-Québec Bylaw No. 633 on the exercise of power by Hydro-Québec's Board of Directors and other administrative measures. The Board analyzes and adopts the Strategic Plan, which defines the company's main objectives, and the annual Business Plan, which establishes the budgets for each division and unit, and sets the company's annual performance targets. Other Board functions include the monthly review of financial results, the four-month review of management results, the periodic evaluation of integrated enterprise risk management and the selection and evaluation of senior executives. In addition, the Board regularly receives and analyzes the subsidiaries' activity reports, financial results and accountability reports.

Independence

With the exception of the President and Chief Executive Officer, all of the Board members come from outside the company. The Board is responsible for compliance, at all times, with the rules stated in the *Code of Ethics and Rules of Professional Conduct for Directors, Executives and Controllers of Hydro-Québec*, which are based on the *Regulation respecting the ethics and professional conduct of public office holders*. Any nonfulfillment of the obligations defined in this code is drawn to the attention of the Chairman of the Board, who also chairs the Ethics and Corporate Governance Committee.

Director training

Directors all receive information on the energy sector and Hydro-Québec's business environment and principal activities. They also receive a director's manual describing the company's specific technical, business and regulatory context, as well as the roles and responsibilities of a Board member. In addition, Board committee members receive a manual describing the committee's mandate and containing a series of backgrounders and reports to facilitate understanding of the issues and decision making. These manuals were entirely updated in 2005. External training is also available to complement directors' knowledge.

Operation

The Board benefits from the expertise and experience of its members, who sit on ten active committees: Distribution, Environment and Corporate Social Responsibility, Ethics and Corporate Governance, Finance, Pension Plan Financial Management, Generation, Human Resources, Technology, Transmission and Audit. Committee members may obtain opinions from outside experts on topics relevant to their areas of responsibility according to an established procedure. After every committee meeting, the committee chair presents a verbal report at the next Board meeting.

The Ethics and Corporate Governance Committee is responsible for assessing the Board's performance and operation. In 2005, the Chairman of the Board introduced a self-assessment process for the Board, the results of which have been submitted to the Ethics and Corporate Governance Committee.

Deintegration

In 1997, Hydro-Québec created an organizational structure that allows some units to work independently from each other while remaining part of the same company. That is the principle of deintegration, or unbundling.

The operations of these units are subject to specific rules of ethics. The electricity supply process is governed by the *Code of Ethics on Conducting Calls for Tenders*, which was adopted by Hydro-Québec Distribution and approved by the Board of Directors and the Régie de l'énergie. This code ensures that calls for tenders are conducted fairly for all electricity suppliers. The Régie follows up annually on its application.

Hydro-Québec TransÉnergie abides by the *Transmission Provider Code of Conduct* approved by the Régie in 2004. This code governs relations between the Transmission Provider and Hydro-Québec affiliates, and its purpose is to prevent any form of preferential treatment or cross-subsidization. Breaches of the code are made public on the OASIS (Open Access Same-Time Information System) Web site.

Access to documents and protection of personal information

Hydro-Québec takes the necessary measures to assure its customers, suppliers and employees of the confidentiality of the information it possesses, in accordance with the *Act respecting Access to documents held by public bodies and the Protection of personal information*.

Policy on the independence of external auditors

Hydro-Québec has introduced various mechanisms to enable the Audit Committee to ensure that external auditors remain independent:

- A process whereby any assignment to be given to external auditors is analyzed first to ensure that it will not affect their independence; external auditors cannot be authorized to provide services that are prohibited
- Rules requiring prior approval of all requisitions for services sent to the external auditors
- Reports to the Audit Committee on the fees billed by the external auditors
- Measures to guarantee compliance with the partner rotation rules

Auditors' fees

KPMG LLP and Ernst & Young LLP are the joint auditors for Hydro-Québec for 2005. Professional fees billed by external auditors in 2005 for services other than auditing amounted to less than 6% of the total $3.4 million in fees billed.

Language guidelines

Efforts to maintain the quality of French used at Hydro-Québec continued during the year. Various proficiency courses in French were offered to employees. The terminology, toponymy and language resources that are available to all employees were enhanced. In addition, various promotional and awareness activities were held during Francofête, a celebration of French language and culture.

The Board of Directors of Hydro-Québec is composed of a maximum of 16 members appointed by the Québec government for terms of no more than five years, as well as the President and Chief Executive Officer, who is appointed by the Board with government approval. The Deputy Minister of Natural Resources is an ex officio, non-voting member of the Board.

Main activities in 2005

The Board of Directors met 11 times in 2005 and its committees met 57 times.

In April, André Caillé became Chairman of the Board and Thierry Vandal took over as President and Chief Executive Officer of Hydro-Québec. In May, the new Deputy Minister of Natural Resources and Wildlife, Normand Bergeron, joined the Board. In the fall, Michael L. Turcotte replaced Mr. Caillé as Chairman of the Board, and Marie-Anne Tawil was appointed to the Board as a director.

The Board's recurring deliberations dealt with the objectives and financial results of Hydro-Québec and its wholly owned subsidiaries, as well as financial management of the company's pension plan.

Throughout the year, the Board oversaw the strategic planning exercise leading up to the *Strategic Plan 2006–2010*. As part of this process, it approved the company's main business objectives in energy efficiency, technological innovation, and the complementary development of hydropower and wind power. It also identified and assessed the main risks that Hydro-Québec faces and ensured that the appropriate systems are in place to manage these risks effectively.

In February, the Board approved the first phase of a distribution system automation project that will last until 2008. This new technology will enable the company to improve the service continuity index.

In light of concerns related to security at Hydro-Québec facilities, the Board approved the deployment of a security plan involving different security levels based on the strategic importance of each facility.

In June, the Board also approved the sale of the assets and liabilities of the subsidiary HydroSolution, Limited Partnership.

In August, the Board authorized construction of the lines and substations needed to bring power from Chute-Allard and Rapides-des-Cœurs generating stations onto the transmission grid. These facilities are scheduled for commissioning in 2007. The Board also approved the work required to connect Péribonka generating station. The lines and substations will come into service progressively from September 2007 to June 2008.

In November, the Board approved the sale of Hydro-Québec's stake in Cross-Sound Cable Company, LLC, held through TransÉnergie HQ inc., to Babcock & Brown Infrastructure Ltd.

The Human Resources Committee examined Senior Management's initiative to identify and train high-potential managers among company employees, in accordance with the corporate succession support plan.

The Environment and Social Responsibility Committee reviewed the company's major donations to organizations in various fields: social and humanitarian, culture, sports, health and education.

Tribute to André Caillé

In September 2005, André Caillé left his position as Chairman of the Board, a post he had held for five months. It was mainly during his nine years as President and Chief Executive Officer, however, that he left his mark on Hydro-Québec.

On joining the company in 1996, Mr. Caillé immediately put together a team of seasoned executives and focused on making Hydro-Québec grow, in an energy market that was then undergoing tremendous changes. He restructured the organization around its core business operations and created divisions for which he set clear profitability objectives. In addition, he secured recognition for the company as a wholesale power marketer, allowing it to maintain an active presence on markets in northeast North America.

His effective management of the business and of crises revealed him to be a man of great talent. His charisma and natural gift for bringing people together prompted employees to rally around his vision. Hydro-Québec also benefited from his keen understanding of the industry.

We are grateful to Mr. Caillé for his tireless commitment to Hydro-Québec and for the legacy he has left us: an efficient, profitable company that plays its full part as a driving force in the province's economy.

André Caillé

Part I – Interpretation and application

1. In this Code, unless the context indicates otherwise:

a) **"director"** means, with respect to the Company, a member of the Board of Directors of the Company, whether or not working full-time within the Company;

b) **"Committee"** or "Ethics and Corporate Governance Committee" means the Ethics and Corporate Governance Committee established by resolution of the Board of October 17, 1997 (HA-173/97), a copy of which is attached in Schedule D;

c) **"spouse"** includes marriage partners and persons living as if married for more than one year;

d) **"Board"** means the Board of Directors of the Company;

e) **"contract"** includes a proposed contract;

f) **"control"** means the direct or indirect ownership of securities, including shares, conferring more than 50% of voting rights or economic interest without this right depending on the occurrence of a particular event or allowing the election of the majority of directors;

g) **"controller"** means the controller of the Company and the controllers of divisions or groups or units reporting to the President and Chief Executive Officer of the Company;

h) **"executive"** with respect to the Company means any contractual manager whose employment conditions are subject to the approval of the Board;

i) **"enterprise"** means any form that can be taken by the organization for the production of goods or services or any other business of a commercial, industrial or financial nature or any group seeking to promote certain values, interests or opinions or to exercise an influence on public officials; however, this does not include the Company or a non-profit association or group that has no financial link with the Company or is not incompatible with the objects of the Company;

j) **"affiliated enterprise"** means a legal person or company in which the Company owns, directly or indirectly, securities, including shares, conferring more than 10% of voting rights or economic interest;

k) **"immediate family"** means spouse and dependent children;

l) **"subsidiary"** means a legal person or company controlled directly or indirectly by the Company.

m) **"Regulation"** means the *Regulation respecting the ethics and professional conduct of public office holders* (Order-in-Council 824-98 of June 17, 1998 (1998) 130 G.O. II, 3474, pursuant to sections 3.01 and 3.02 of the *Act respecting the Ministère du Conseil exécutif*, R.S.Q., c. M-30), as amended from time to time;

n) **"Company"** means Hydro-Québec.

2. In this Code, the prohibition to perform an act also applies to any attempt to perform it and any participation in it or incitement to perform it.

2.1 This Code applies to the directors, the President and Chief Executive Officer, other executives of the Company and its controllers.

The directors and the President and Chief Executive Officer are also subject to the Regulation.

Part II – Ethical principles and general rules of professional conduct

3. The director, executive or controller is appointed to contribute to the achievement of the Company's mission in the best interest of Québec. Accordingly, he is expected to use his knowledge, abilities and experience in a way that will promote the effective, fair and efficient accomplishment of the objectives assigned to the Company by law and the good administration of the property it owns as mandatary of the State.

His contribution shall be made with respect for the law and with honesty, loyalty, prudence, diligence, efficiency, application and fairness.

3.1 The director, executive or controller respects the following principles in the performance of his duties:

- a vision of the Company that seeks to make it a world leader in the energy industry by developing its expertise for the benefit of its customers, employees and shareholder and by working with partners in business ventures;
- the values underlying the activities of the Company as a government-owned business Company, which include customer satisfaction, a "business first" approach, respect for employees, quality improvement, respect for the environment, partnership with local communities and safeguarding the future; and
- the principles set out in the basic policies of the Company, expressing commitments and conveying a business culture with regard to customers, human resources, acquisition of assets and services, business partners, finance, assets, the environment, social role and corporate governance.

3.2 The director, executive or controller is required, in the performance of his duties, to respect the ethical principles and rules of professional conduct provided by law, the Regulation as applicable, and those defined in this Code. In case of discrepancy, the more stringent rules and principles apply.

When in doubt, act according to the spirit of these principles and rules.

A director, executive or controller who, at the request of the Company, serves as director or member of an undertaking or a company, is held to the same standards.

4. The director, executive or controller shall not merge the assets of the Company with his own; he may not use the assets of the Company or information he obtains as a result of his duties for his own profit or the profit of others. These obligations continue even after the director, executive or controller has ceased to hold his position.

5. The director, executive or controller shall seek, in the performance of his duties, only the interest of the Company to the exclusion of his own interest or that of others.

5.1 The director, executive or controller is bound to discretion in regard to anything that comes to his knowledge in or during the performance of his duties and is at all times bound to maintain the confidentiality of such information.

5.2 In the performance of his duties, the director, executive or controller shall make decisions without regard for any partisan political considerations.

The Chairman of the Board, the director working full-time within the Company, the executive and the controller shall demonstrate reserve in the public expression of their political opinions.

6. The director, executive or controller may not directly or indirectly grant, solicit or accept a favor or an undue advantage for himself or for a third party.

In particular, he may not accept or solicit an advantage from a person or undertaking doing business with the Company or a subsidiary or acting in the name of or on behalf of such a person or undertaking if this advantage is intended or likely to influence him in the performance of his duties or generate expectations of this nature.

6.1 The director, executive or controller shall, in making decisions, avoid allowing himself to be influenced by offers of employment.

6.2 The director, executive or controller may not accept any gift or hospitality except what is customary and modest in value.

Any other gift or hospitality shall be returned to the giver.

7. The director may not make a commitment to a third party or grant them any guarantee relative to a vote he may be asked to make or any decision whatsoever that the Board may be asked to make.

7.1 The director, executive or controller may not, in the performance of his duties, deal with a person who has ceased to be a director, executive or controller of the Company for less than one year if this person is acting on behalf of a third party with respect to a proceeding, negotiation or other transaction to which the Company is a party and about which he has information not available to the public.

7.2 After ceasing his duties, no director, executive or controller may disclose confidential information he has obtained or give anyone advice based on information not available to the public concerning the Company or any other undertaking or company with which he had direct and substantial dealings during the year preceding the date on which he ceased his duties.

In the year following that date, he may not act on behalf or on account of another party with respect to a procedure, negotiation or other transaction to which the Company is a party and about which he has information not available to the public.

8. The director, executive or controller shall collaborate with the Chairman of the Board or the Ethics and Corporate Governance Committee on an issue of ethics or professional conduct when asked to do so.

8.1 The director, executive or controller who intends to be a candidate for elective office shall inform the Chairman of the Board of this intention.

The Chairman of the Board or President and Chief Executive Officer with the same intention shall inform the Secretary General of the Conseil exécutif.

Part III – Duties and obligations of directors, executives and controllers with respect to conflicts of interest

Prevention of conflicts of interest

9. The director, executive or controller shall avoid placing himself in a situation in which his personal interest is in conflict with the duties of his position or in which reasonable doubt is cast on his ability to perform these duties with undivided loyalty.

A director who is employed full-time within the Company or one of its subsidiaries shall also avoid performing duties or being bound by commitments that prevent him from devoting the time and attention that the normal exercise of his duties requires.

As for other directors, they shall be sure to devote the time and attention reasonably required in the circumstances for the execution of their duties.

10. No director holding a full-time office with the Company, under pain of forfeiture of office, may have any direct or indirect interest in an undertaking, company or association that puts his personal interest in conflict with that of the Company.

However, such forfeiture is not incurred if that interest devolves to him by succession or gift, provided that he renounces or disposes of it with all possible dispatch. Meanwhile, sections 12, 13, 15 and 18 apply to this director.

Every other director who has an interest in an undertaking shall, on pain of forfeiture of his office, comply with the provisions of sections 12, 13, 15 and 18.

11. A director, executive or controller of the Company who serves as director, executive or controller of an affiliated enterprise shall be specifically authorized by the shareholder or shareholders who control the enterprise concerned to:

a) hold shares, rights or any other security issued by such enterprise and conferring voting rights or economic interest in it or the right to subscribe or buy such shares, rights or securities;

b) benefit from any profit-sharing program, unless this director, executive or controller works full-time for the enterprise and the profit-sharing program is closely linked with the individual performance of the director, executive or controller within the affiliated enterprise;

c) benefit from a pension plan granted by the affiliated enterprise if he does not hold a full-time position within the enterprise; or

d) benefit from any advantage granted in advance in the case of a change of control of the affiliated enterprise.

12. A director, executive or controller who:

a) is party to a contract with the Company or a subsidiary, or

b) has a direct or indirect interest in an enterprise that is a party to a contract with the Company or a subsidiary or is a director, executive, controller or employee of this enterprise,

shall disclose the nature and extent of his interest in writing to the Chairman of the Board.

The same applies to a director who has a direct or indirect interest in any issue being considered by the Board of Directors.

The director shall at all times abstain from conveying any information of any kind to any employee, controller, executive or director of the Company with respect to this contract or interest.

The director shall abstain from deliberating or voting on any question linked to this interest and avoid trying to influence the related decision. The director shall also withdraw from the meeting for the duration of deliberations and voting on this question.

12.1 A director who is a member of the Audit Committee of the Board of Directors may not have an interest in the Company or a subsidiary. In particular, he may not accept from the Company or a subsidiary fees with respect to consulting, consulting services or any other similar service.

13. The disclosure required by section 12 occurs, in the case of a director, during the first meeting:

a) in the course of which the contract or question concerned is under study;

b) following the time at which the director who had had no interest in the contract or question concerned acquires such interest;

c) following the time at which the director acquires an interest in the already concluded contract; or

d) following the time at which any person with an interest in a contract or a question under study becomes a director.

14. An executive or controller who is not a director shall make the disclosure required in section 12 immediately after:

a) having learned that the contract or question concerned was or will be studied at a meeting;

b) having acquired the interest, if it is acquired after the contract was concluded or the decision made; or

c) having become an executive or controller, if he becomes one after acquiring the interest.

The executive or controller may not try to influence the directors' decision in any way.

15. The director, executive or controller shall make the disclosure required in section 12 as soon as he has knowledge of a contract contemplated by this section which, as part of the normal business of the Company, does not require the approval of the directors.

16. Sections 12 to 15 apply also when the interest concerned is held by a member of the immediate family of the director, executive or controller.

17. The director, executive or controller shall notify the Chairman of the Board in writing of the rights he may invoke against the Company, by indicating their nature and their value, as soon as these rights come into existence or when he acquires knowledge of them.

18. The director, executive or controller shall submit to the Chairman of the Board, within 60 days of being appointed and on January 31 of each year in which he remains in office, an attestation in the form provided in Schedule B and containing the following information:

a) the name of any enterprise in which the director, executive or controller owns, directly or indirectly, securities or assets, including common shares, specifying the nature and quantity in number and proportion of securities owned and value of assets;

b) the name of any enterprise for which he performs functions or in which he has an interest in the form of a debt, right, priority, mortgage or significant commercial or financial benefit; and

c) to the best of his knowledge, the information specified in the preceding paragraphs concerning his employer and the corporation, company or enterprise of which he is owner, shareholder, director, executive or controller.

A director, executive or controller to whom the provisions of paragraphs a) to c) do not apply shall fill out an attestation to that effect and present it to the Chairman of the Board.

The director, executive or controller shall also produce such an attestation within 60 days of the occurrence of a significant change in its content.

The attestations presented pursuant to this section are treated as confidential.

19. The Chairman of the Board submits the attestations received pursuant to sections 12 to 18 to the Secretary of the Company, who keeps them at the disposal of the members of the Board and the Ethics and Corporate Governance Committee.

Moreover, the Secretary of the Company notifies the Ethics and Corporate Governance Committee of any failure to satisfy the obligations provided for in sections 12 to 18 as soon as the Secretary becomes aware of them.

Waivers

20. This Code does not apply:

a) to owning securities when the size of the holding probably does not place the director, executive or controller in a conflict of interest;

b) to owning an interest by way of a mutual fund in whose management the director, executive or controller plays no role directly or indirectly;

c) to owning interests through a blind trust whose beneficiary cannot know its makeup;

d) to owning a minimum number of shares required to be eligible as director of a corporation;

e) to an interest which, by its nature and extent, is common to the public at large or a particular sector in which the director, executive or controller operates;

f) to a directors' liability insurance agreement; or

g) to the owning of shares issued or guaranteed by the Company, a government or municipality under the same conditions for everyone.

Attestation

20.1 Within sixty days of the adoption of this Code by the Board, each director, executive or controller shall submit to the Chairman of the Board and the Secretary of the Company the attestation appearing in Schedule C.

Each new director, executive or controller shall do the same within sixty days of his appointment to this position.

Part IV – Remuneration

20.2 The director, executive or controller, for the exercise of his duties, is entitled solely to the remuneration related to those duties. Such remuneration may not include, even partially, monetary advantages such as those established, in particular, by a profit-sharing plan based on the variation in the value of shares or on a stake in the capital stock of the Company.

20.3 A director, executive or controller dismissed for just and sufficient cause may not receive a severance allowance or payment.

20.4 A director, executive or controller who quits his duties, who has received or is receiving a severance allowance or payment and who holds an office, employment or any other remunerated position in the public sector during the period corresponding to that allowance or payment shall refund the part of the allowance or payment covering the period for which he receives a salary or shall cease to receive it during that period.

However, if the salary he receives is lower than that he received previously, he shall be required to refund the allowance or payment only up to the amount of his new salary, or he may continue to receive the part of the allowance or payment that exceeds his new salary.

20.5 Anyone who has received or is receiving a severance allowance or payment from the public sector and receives a salary as director, executive or controller during the period corresponding to that allowance or payment shall refund the part of the allowance or payment covering the period for which he receives a salary or shall cease to receive it during that period.

However, if the salary he receives as director, executive or controller is lower than that he was receiving previously, he shall be required to refund the allowance or payment only up to the amount of his new salary, or he may continue to receive the part of the allowance or payment that exceeds his new salary.

20.6 A President and Chief Executive Officer who has ceased to perform his duties, who has received so-called assisted departure measures and who, within two years after his departure, accepts an office, employment or any other remunerated position in the public sector shall refund the sum corresponding to the value of the measures received by him, up to the amount of the remuneration received, by the fact of his return to the public sector, during that two-year period.

20.7 Part-time teaching by a director, executive or controller is not covered by sections 20.4 to 20.6.

20.8 For the application of sections 20.4 to 20.6, "public sector" means the bodies, institutions and companies referred to in the Regulation in Schedule A.

The period covered by the severance allowance or payment referred to in 20.4 and 20.5 shall correspond to the period that would have been covered by the same amount if the person had received it as salary in his prior office, employment or position.

Part V – Application of the code

Competent authorities

20.9 The Associate Secretary General for Senior Positions of the Ministère du Conseil exécutif is the competent authority for the application of this Code with respect to the Chairman of the Board and the other directors of the Company appointed by the Government.

The Chairman of the Board is the competent authority with respect to all directors of wholly owned subsidiaries, executives or controllers of the Company.

The Chairman of the Board shall ensure observance of the ethical principles and rules of professional conduct by the directors, executives and controllers of the Company.

21. The Ethics and Corporate Governance Committee has as its mission to advise the competent authority with respect to ethics and professional conduct.

The Committee also performs the duties invested in it by the resolution appearing in Schedule D and performs any other duties related to ethics entrusted to it by the Board.

In the performance of its duties, the Ethics and Corporate Governance Committee may become acquainted with the attestations contemplated by section 19.

22. When a director, executive or controller is accused of a violation of ethics or the rules of professional conduct, the Committee is responsible for collecting all relevant information. It makes a report of its findings to the competent authority and recommends appropriate measures, if any.

The competent authority notifies the director, executive or controller of the alleged violations and the possible penalties. It informs him that he has seven days in which to respond and if he requests, to be heard on this matter.

23. The Committee may render advisory opinions to directors, executives or controllers on the provisions of this Code and their application to specific cases, even hypothetical ones. It is not required to limit its views to the terms contained in the request.

23.1 In order to allow an appropriate decision to be made in the case of an urgent situation requiring fast response or in an alleged case of serious misconduct, the competent authority may temporarily relieve of his duties, with remuneration, the director, executive or controller who is accused of violations of ethics or the rules of professional conduct.

24. The Secretary of the Company keeps records in which are stored the statements, disclosures and attestations that must be submitted to it under this Code, the reports, decisions and advisory opinions of the Committee and the decisions of the competent authority with respect to ethics and professional conduct.

The Secretary shall also take the necessary steps to ensure the confidentiality of the information provided by the directors, executives and controllers pursuant to this Code.

25. The Committee may consult and receive opinions from outside counsel or experts on any issue it considers appropriate.

26. A director, executive or controller does not violate the provisions of this Code if he has obtained in advance a favorable decision from the Committee on the following conditions:

a) the decision was obtained before the facts on which it was based became a reality;

b) the decision was submitted to the Board;

c) all of the relevant facts were fully disclosed to the Committee exactly and completely; and

d) the director, executive or controller has complied with all the requirements of the decision.

27. The Committee and the competent authority preserve the anonymity of complainants, applicants and informers unless there is a clear intention to do otherwise. They may not be forced to reveal information likely to disclose their identity except if the law or a court so requires.

Penalties

28. Upon concluding that a provision of the law, the Regulation or this Code has been violated, the competent authority may impose either of the following penalties:

a) for an executive or a controller, the appropriate penalty, which can extend as far as termination of employment; and

b) for a director, reprimand, suspension without remuneration for a maximum of three months, or removal from the Board.

However, when the competent authority is the Associate Secretary General contemplated by section 20.9, the penalty is imposed by the Secretary General of the Conseil exécutif. If the penalty proposed consists of the removal of a public office holder appointed or designated by the Government, it can only be imposed by the latter; in this case, the Secretary General of the Conseil exécutif may immediately suspend the public office holder without remuneration for a period not exceeding 30 days.

Any penalty imposed on a director and the decision to temporarily relieve him of his duties must be in writing and give the reasons therefor.

29. In the case of a violation of section 10, the competent authority records in writing the forfeiture of office of the violator.

30. The director, executive or controller shall render an account and restore to the Company any profits earned or benefits received as a result of or on the occasion of a violation of the provisions of this Code.

31. A director's vote shall not be a casting vote if it is made in violation of the provisions of this Code or associated with such a violation, or if the director fails to produce the attestation contemplated by section 18.

The schedules may be consulted on Hydro-Québec's Web site (www.hydroquebec.com).

Generating and Transmission Facilities *as at December 31, 2005*

Generation Installed capacity in MW

Hydroelectric generating stations[a]			
Robert-Bourassa	5,616	Brisay	469
La Grande-4	2,779	Laforge-2	319
La Grande-3	2,418	Trenche	303
La Grande-2-A	2,106	Beaumont	270
Beauharnois	1,667	Rocher-de-Grand-Mère	230
Manic-5	1,528	La Tuque	220
La Grande-1	1,436	Rapide-Blanc	204
Manic-3	1,244	Paugan	202
Bersimis-1	1,125	Shawinigan-2	200
Manic-5-PA	1,064	Manic-1	184
Manic-2	1,024	Shawinigan-3	184
Outardes-3	959	Rapides-des-Îles	176
Sainte-Marguerite-3	883	Chelsea	153
Laforge-1	878	Les Cèdres	135
Bersimis-2	845	Première-Chute	130
Carillon	752	La Gabelle	129
Outardes-4	669	Grand-Mère	105
Toulnustouc	526	Other (18 generating stations rated less than 100 MW)	695
Outardes-2	472		

Thermal generating stations (conventional)			
Tracy	600	Other (24 diesel units)	125
Bécancour, La Citière and Cadillac (gas turbine)	870		

Nuclear generating station	
Gentilly-2	675

Wind farm	
Saint-Ulric (3 wind turbines)	2

Installed capacity	
Hydroelectric (54)	32,299
Conventional thermal (28)	1,595
Nuclear (1)	675
Wind (1)	2
Total	**34,571**[b]

Hydroelectric generating stations under construction Capacity in MW	
Eastmain-1	480
Péribonka	385
Chute-Allard and Rapides-des-Cœurs	138
Mercier	51

a) The installed capacity of a hydroelectric generating station is equivalent to that of its generating units operating in winter conditions (water temperature 5°C).

b) In addition to the installed capacity of its own generating stations, Hydro-Québec has access to most of the output from Churchill Falls, which has a rated capacity of 5,428 MW, and to all of the output from the 196 turbines at five wind farms with a total installed capacity of 210 MW.

Transmission

Voltage	Lines (km)	Substations (number)
765 and 735 kV	11,422	38
450 kV DC	1,218	2
315 kV	5,068	62
230 kV	2,976	50
161 kV	1,875	40
120 kV	6,600	213
69 kV or less	3,385	100
Total	**32,544**	**505**

HUDSON BAY
JAMES BAY
La Grande-4
La Grande-3
La Grande-2
La Grande-1
Radisson
Nemiscau
QUÉBEC
Chute-Allard
Appalaches-Les Cantons
Frontenac
Montréal
Beauharnois
Outardes-4
Outardes-3
Manicouagan-5
Manic-5-PA
Manic-3
Manic-2
Hydro-Québec
Manic-1
Outardes-2
ST. LAWRENCE RIVER
PRINCE EDWARD ISLAND
NEW BRUNSWICK
NOVA SCOTIA
MAINE
ONTARIO
VERMONT
LAKE ONTARIO
NEW YORK
NEW HAMPSHIRE
UNITED STATES
ATLANTIC OCEAN
MASSACHUSETTS
R.I.
CONNECTICUT
PENNSYLVANIA
NEW JERSEY
Generating station rated 300 MW or more
Generating station under construction
735-kV substation
450-kV direct-current line
735-kV line
Interconnection
Neighboring system facility

Major Facilities

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is responsible for investment and the sale of professional services outside Canada and the U.S. Since HQI has entrusted Hydro-Québec with the management of its operations, each Hydro-Québec division is responsible for foreign operations in its spheres of competence.

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Units of measure

¢/kWh	cents ($0.01) per kilowatthour
$M	millions of dollars
$B	billions of dollars
kV	kilovolt (one thousand volts)
kW	kilowatt (one thousand watts)
MW	megawatt (one million watts)
GW	gigawatt (one million kilowatts)
kWh	kilowatthour (one thousand watthours)
MWh	megawatthour (one million watthours)
GWh	gigawatthour (one million kilowatthours)
TWh	terawatthour (one billion kilowatthours)
km	kilometre
m²	square metre

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Sustainability Report 2005

Financial Profile 2005–2006

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